

AUDITED CONSOLIDATED FINANCIAL STATEMENTS  
AND SUPPLEMENTARY INFORMATION

Boston Children's Hospital and Subsidiaries  
Years Ended September 30, 2017 and 2016  
With Reports of Independent Auditors

Ernst & Young LLP



Building a better  
working world

Boston Children’s Hospital and Subsidiaries

Audited Consolidated Financial Statements  
and Supplementary Information

Years Ended September 30, 2017 and 2016

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Ernst & Young LLP  
200 Clarendon Street  
Boston, MA 02116

Tel: +1 617 266 2000  
Fax: +1 617 266 5843  
ey.com

## Report of Independent Auditors

The Board of Trustees  
Boston Children's Hospital

We have audited the accompanying consolidated financial statements of Children's Medical Center Corporation and Subsidiaries (d/b/a Boston Children's Hospital and Subsidiaries), which comprise the consolidated balance sheets as of September 30, 2017 and 2016, 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 did not audit the financial statements of the Physician's Organization at Children's Hospital, Inc. (the P.O.) and the Physician Foundations (the Foundations), controlled affiliates, which statements reflect total assets of \$1,273 million and \$1,171 million and total revenues of \$702 million and \$675 million as of and for the years ended September 30, 2017 and 2016, respectively, of the related consolidated totals. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for the P.O. and the Foundations, is based solely on the report of the other auditors. 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, based on our audits and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Children's Medical Center Corporation and Subsidiaries at September 30, 2017 and 2016, and the consolidated results of their operations and changes in net assets and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

*Ernst + Young LLP*

January 12, 2018

## Boston Children's Hospital and Subsidiaries

### Consolidated Balance Sheets (In Thousands)

	<b>September 30</b>	
	<b>2017</b>	<b>2016</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 172,884	\$ 154,236
Patient accounts receivable, net of allowance for uncollectible accounts of \$65,288 and \$50,747 in 2017 and 2016, respectively	<b>302,768</b>	270,107
Other receivables	<b>45,617</b>	50,305
Grants receivable	<b>52,072</b>	39,311
Current portion of pledges receivable, net	<b>32,791</b>	40,130
Other current assets	<b>59,504</b>	42,223
Total current assets	<b>665,636</b>	596,312
Investments:		
Unrestricted as to use	<b>2,154,900</b>	1,838,046
Limited by Board designation	<b>2,646,645</b>	2,228,760
Restricted by donor-imposed restriction	<b>615,990</b>	572,351
	<b>5,417,535</b>	4,639,157
Other assets whose use is limited:		
By externally administered trusts	<b>49,540</b>	47,881
For deferred compensation and other benefit obligations	<b>152,772</b>	150,815
By long-term debt agreements	<b>2,568</b>	2,517
Other	<b>3,820</b>	3,735
	<b>208,700</b>	204,948
Property, plant, and equipment, net	<b>1,214,522</b>	1,174,051
Goodwill and other intangible assets	<b>39,216</b>	41,776
Pledges receivable, net	<b>75,312</b>	88,169
Other assets	<b>79,854</b>	69,027
Total assets	<b>\$ 7,700,775</b>	\$ 6,813,440

Boston Children's Hospital and Subsidiaries

Consolidated Balance Sheets (continued)  
(In Thousands)

	<b>September 30</b>	
	<b>2017</b>	<b>2016</b>
<b>Liabilities and net assets</b>		
Current liabilities:		
Accounts payable and accrued expenses	\$ 179,062	\$ 173,965
Accrued salaries and wages	143,052	117,204
Current portion of estimated third-party settlement liabilities	5,870	3,248
Current portion of long-term debt	1,200	1,100
Current portion of mortgage notes payable	37,416	814
Deferred revenue	65,161	55,737
Other current liabilities	6,356	1,376
Total current liabilities	<b>438,117</b>	353,444
Long-term liabilities:		
Long-term debt	1,214,266	868,717
Mortgage notes payable	27,000	64,421
Estimated third-party settlement liabilities	10,557	10,350
Net pension liability	81,953	171,783
Funds held for others	37,882	45,889
Interest rate swap liability	135,242	177,094
Deferred compensation and other benefit obligations	128,259	132,743
Other liabilities	138,535	138,365
Total long-term liabilities	<b>1,773,694</b>	1,609,362
Net assets:		
Unrestricted	4,715,331	4,102,103
Temporarily restricted	518,256	507,194
Permanently restricted	255,377	241,337
Total net assets	<b>5,488,964</b>	4,850,634
Total liabilities and net assets	<b>\$ 7,700,775</b>	<b>\$ 6,813,440</b>

See accompanying notes.

## Boston Children's Hospital and Subsidiaries

### Consolidated Statements of Operations and Changes in Net Assets (In Thousands)

	<b>Year Ended September 30</b>	
	<b>2017</b>	<b>2016</b>
<b>Revenues:</b>		
Patient services revenue, net of contractual allowances and discounts	\$ 2,027,343	\$ 1,886,425
Provision for uncollectible accounts	(71,683)	(65,264)
Net patient services revenue	1,955,660	1,821,161
Research grants and contracts	207,567	185,706
Recovery of indirect costs on grants and contracts	79,421	71,322
Other operating revenue	106,176	110,829
Royalty settlement	34,082	-
Unrestricted contributions, net of fundraising expenses of \$9,341 and \$8,721 in 2017 and 2016, respectively	13,815	12,724
Net assets released from restrictions used for operations	65,284	65,487
Total revenues	2,462,005	2,267,229
<b>Expenses:</b>		
Salaries and benefits	1,403,530	1,345,889
Supplies and other expenses	573,850	537,310
Costs related to royalty settlement	10,479	-
Direct research expenses of grants	207,567	185,706
Health Safety Net assessment	22,896	10,101
Depreciation and amortization	132,228	125,435
Costs related to asset dispositions	13,728	-
Interest and net interest rate swap cash flows	41,242	34,200
Total expenses	2,405,520	2,238,641
Gain from operations	56,485	28,588
<b>Non-operating gains (losses):</b>		
Income from investments	57,438	37,073
Net realized gains on investments	93,773	47,605
Unrealized gains on investments classified as trading securities, net	33,605	10,011
Increase in value of alternative investments, net	137,097	97,959
Recognition of unrealized losses on other than trading investments	(7,730)	(27,188)
Fundraising expenses on restricted contributions	(21,795)	(20,349)
Adjustment of interest rate swaps to fair value	41,852	(30,780)
Other non-operating losses	(7,213)	(4,475)
Total non-operating gains, net	327,027	109,856
Excess of revenues over expenses	383,512	138,444

## Boston Children's Hospital and Subsidiaries

### Consolidated Statements of Operations and Changes in Net Assets (continued) (In Thousands)

	<b>Year Ended September 30</b>	
	<b>2017</b>	<b>2016</b>
Changes in unrestricted net assets:		
Excess of revenues over expenses (continued from page 5)	\$ 383,512	\$ 138,444
Net unrealized gain on other than trading investments	133,962	122,866
Net asset transfer and released from restrictions, net	(695)	545
Appreciation (depreciation) on endowment funds	4,116	(1,035)
Pension adjustment	92,333	(76,984)
Increase in unrestricted net assets	<b>613,228</b>	183,836
Changes in temporarily restricted net assets:		
Contributions	44,766	63,165
Income and net realized gain on investments	15,209	6,077
Recognition of unrealized losses on investments	(1,587)	(5,535)
Increase in value of alternative investments	23,671	16,486
Net unrealized (loss) gain on investments	(2,317)	6,353
Net asset transfer	(810)	(65)
(Appreciation) depreciation on endowment funds	(4,116)	1,035
Net assets released from restrictions	(63,754)	(66,434)
Increase in temporarily restricted net assets	<b>11,062</b>	21,082
Changes in permanently restricted net assets:		
Contributions	14,065	19,889
Net asset transfer	(25)	467
Increase in permanently restricted net assets	<b>14,040</b>	20,356
Increase in net assets	<b>638,330</b>	225,274
Net assets at beginning of year	<b>4,850,634</b>	4,625,360
Net assets at end of year	<b>\$ 5,488,964</b>	\$ 4,850,634

*See accompanying notes.*



# Boston Children's Hospital and Subsidiaries

## Consolidated Statements of Cash Flows (In Thousands)

	<b>Year Ended September 30</b>	
	<b>2017</b>	<b>2016</b>
<b>Operating activities</b>		
Change in net assets	\$ 638,330	\$ 225,274
Non-cash and non-operating activities included in change in net assets:		
Depreciation and amortization	132,228	125,435
Costs related to asset dispositions	2,413	–
Restricted contributions	(58,831)	(83,054)
Net realized and unrealized gains and losses on investments	(404,779)	(294,300)
Net unrealized gains on investments classified as trading securities, net	(33,605)	(10,011)
Changes in operating assets and liabilities:		
Investments classified as trading securities	44,737	7,396
Patient accounts receivable	(32,661)	(5,540)
Other accounts receivable	(8,073)	(7,103)
Other assets	(28,538)	(19,550)
Accounts payable and accrued expenses	30,945	9,368
Estimated third-party settlement liabilities	2,829	1,236
Other liabilities	(126,153)	137,051
Net cash provided by operating activities	158,842	86,202
<b>Financing activities</b>		
Payments of note payable	(819)	(766)
Payments of promissory notes	(3,446)	–
Proceeds from bond issuance	350,000	–
Bond payments	(1,100)	–
Payments of bond issuance costs	(3,100)	–
Capital lease payments	–	(271)
Increase (decrease) in pledges receivable	20,196	(14,736)
Restricted contributions	58,831	83,054
Net cash provided by financing activities	420,562	67,281
<b>Investing activities</b>		
Purchases of investments	(1,220,829)	(746,637)
Proceeds from sales of investments	836,098	792,351
Additions to fixed assets, net of retirements	(172,273)	(212,020)
(Increase) decrease in other assets whose use is limited	(3,752)	26,456
Net cash used in investing activities	(560,756)	(139,850)
Net increase in cash and cash equivalents	18,648	13,633
Cash and cash equivalents at beginning of year	154,236	140,603
Cash and cash equivalents at end of year	\$ 172,884	\$ 154,236

*See accompanying notes.*

# Boston Children's Hospital and Subsidiaries

## Notes to Consolidated Financial Statements

September 30, 2017

### 1. Summary of Significant Accounting Policies

#### Basis of Consolidation

The accompanying consolidated financial statements include the accounts of Children's Medical Center Corporation (d/b/a Boston Children's Hospital) and its subsidiaries (collectively, the Medical Center) including (a) Children's Hospital (the Hospital), which engages in pediatric patient care, research, training, and community service; (b) 15 tax-exempt physician foundations (the Foundations), which are organized for charitable, scientific, and educational purposes, and operate for the benefit of the Hospital and Harvard Medical School (Harvard) by providing medical and health care services primarily to patients at the Hospital and of other health care providers at satellite locations; (c) the Physicians' Organization at Children's Hospital, Inc. (the P.O.), which provides coordination and general oversight of the clinical and medicine practices and related health care services of the Foundations; (d) CHB Properties, Inc., which owns and operates real property and distributes the net income of such property to the Medical Center; (e) Longwood Research Institute, Inc., which holds real property for the benefit of the Hospital in the furtherance of its research mission; (f) Longwood Corporation, which owns and operates real property and distributes the net income of such property to the Medical Center; (g) Boston Children's Health Physicians (BCHP), a fully integrated health care community that provides pediatric inpatient and outpatient care to patients throughout the New York Metropolitan Area, the Hudson Valley, Connecticut and New Jersey; and (h) Blood Research Institute, Inc. (BRI) (see below).

Certain Foundations have fiscal year-ends that differ from the Medical Center's fiscal year-end date of September 30. The Medical Center has consolidated the financial statements of these Foundations based on their most recent audited financial statements as of September 30, 2017, which in no case is more than three months prior to September 30, 2017. All material intervening transactions or events, if any, have been recorded or disclosed in the consolidated financial statements.

All material intercompany balances and transactions are eliminated in consolidation.

#### **Blood Research Institute, Inc.**

BRI, a not-for-profit organization, was incorporated for the purpose of owning and leasing real estate and other property, primarily in connection with and for the benefit of The Immune Disease Institute, Inc. (IDI). On December 28, 2008, the Board of Trustees of IDI and the Board of Trustees of Boston Children's Hospital (BCH) entered into a five-year affiliation agreement to make IDI BCH's sixth multidisciplinary research program, the Program in Cellular and Molecular Medicine. On October 1, 2012, IDI was merged into BCH.

# Boston Children's Hospital and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

### **1. Summary of Significant Accounting Policies (continued)**

On April 5, 2016, BRI amended its Articles of Incorporation and amended and restated its bylaws to name the Hospital, a subsidiary of BCH, as its sole corporate member. As a result, BRI's assets and liabilities have been reflected within the Medical Center's consolidated financial statements as of September 30, 2017 and 2016 and BRI's results of operations have been included within the Medical Center's consolidated statements of operations and changes in net assets from the date the Hospital became BRI's sole corporate member. BRI's financial position and results of operations are not material to the Medical Center's consolidated financial statements.

#### **BCD Hospital Energy Collaborative**

The Hospital obtains electricity, steam, and chilled water from the Medical Area Total Energy Plant (MATEP), which is located in the Longwood Medical and Academic Area of Boston and also provides utilities to a number of neighboring hospitals and medical institutions. On August 2, 2017, BCD Hospital Energy Collaborative, LLC (BCD), a limited liability company owned by the Hospital and other MATEP customers (the BCD Owners), entered into a Purchase and Sale Agreement (the PSA), pursuant to which BCD agreed to acquire 100% of the issued and outstanding interests in Mayflower Energy Holdings LLC (MEH), which owns MATEP. The transaction is non-recourse to the BCD Owners beyond their joint and several guarantee of up to \$25 million of BCD's obligation to pay certain liquidated damages under the PSA.

Subsequent to the execution of the PSA, BCD agreed that it would assign its interests under the PSA to an unrelated entity, Longwood Energy Partners LLC (LEP), subject to receipt of all relevant regulatory approvals. If regulatory approvals are not timely obtained and the assignment does not occur, BCD has agreed to sell the MEH interests to LEP following BCD's acquisition of the interests pursuant to the PSA. The Hospital has agreed, severally and not jointly, to guarantee all payment and performance obligations of BCD under the transaction agreements with LEP, up to a cap of \$16 million, with each of the other BCD Owners providing the same several guarantee.

All of the transactions relating to MATEP are subject to regulatory approval, and there can be no assurance that any of such transactions will be completed.

The Hospital does not have a controlling financial interest in BCD and, thus, the financial position and results of operations of BCD are not reflected in the accompanying consolidated financial statements. The Hospital accounts for its interest in BCD under the equity method of accounting and the Hospital's portion of the operations of BCD did not have a significant impact on the consolidated financial statements as of and for the year ended September 30, 2017.

# Boston Children's Hospital and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

### **1. Summary of Significant Accounting Policies (continued)**

#### **Use of Estimates**

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

#### **Cash and Cash Equivalents**

Cash equivalents include money market instruments with average maturities of less than 90 days, excluding amounts included in investments and other assets whose use is limited. Cash balances maintained with financial institutions may exceed federal depository insurance limits; however, management believes the credit risk related to these financial institutions is minimal. The Medical Center has not experienced any losses in such accounts, and it believes it is not exposed to any significant risk at September 30, 2017.

The Medical Center's cash management system provides for daily investment of available balances and the funding of outstanding checks when presented for payment. Outstanding, but unpresented, checks totaling \$21,511,000 and \$28,105,000 at September 30, 2017 and 2016, respectively, have been included in accounts payable on the consolidated balance sheets. Upon presentation for payment, these checks are funded through available cash balances.

#### **Investments and Other Assets Whose Use Is Limited**

Investments and other assets whose use is limited include the following: Board-designated assets for plant replacement and expansion and mission-related activities; donor-restricted assets and funds held for others (all of which participate in the investment pool); externally managed trusts associated with deferred giving arrangements; assets limited by long-term debt agreements; and deferred compensation (which are invested primarily in mutual funds and government obligations, and are reported at fair value).

# Boston Children's Hospital and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

### **1. Summary of Significant Accounting Policies (continued)**

#### *Medical Center*

The Medical Center follows the practice of pooling resources of unrestricted and restricted assets for long-term investment purposes. The investment pool is operated on the market value method, whereby each participating fund is assigned a number of units based on the percentage of the pool it owns at the time of entry. Income, gains, and losses of the pool are allocated to the funds based on their respective participation in the pool.

Investments in marketable debt and equity securities are stated at fair value determined principally from quoted market prices. Realized gains and losses on investment transactions are computed on an average-cost basis. Net realized gains or losses on unrestricted investments and impairments in investment values that are determined to be other than temporary are reported as non-operating gains (losses). Net unrealized gains or losses on unrestricted investments are recorded as an increase or decrease in unrestricted net assets. Net realized and unrealized gains or losses on restricted investments are recorded as an increase or decrease to the restricted net asset balance. Unrestricted investment income is reported in non-operating gains. Investment income on endowment funds appropriated by the Board of Trustees (the Board) for expenditure is reported as non-operating gains. Restricted investment income is recorded as an increase to the restricted net asset balance.

Real estate purchased and held for investment is accounted for at cost less accumulated depreciation. Alternative investments (non-traditional, not readily marketable holdings) include hedge funds and private equity funds. Alternative investment interests generally are structured such that the Medical Center holds a limited partnership interest. The Medical Center's ownership structure does not provide for control over the related investees and the associated financial risk is limited to the carrying amount reported for each investee, in addition to any unfunded capital commitment. Future funding commitments for alternative investments aggregated approximately \$255,023,000 and \$212,042,000 at September 30, 2017 and 2016, respectively.

Alternative investments are reported on the accompanying consolidated balance sheets based upon net asset values derived from the application of the equity method of accounting. Financial information used by the Medical Center to evaluate its alternative investments is provided by the investment manager or general partner and includes fair value valuations (quoted market prices and values determined through other means) of underlying securities and other financial instruments held by the investee, and estimates that require varying degrees of judgment. The

# Boston Children's Hospital and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

### **1. Summary of Significant Accounting Policies (continued)**

financial statements of the investee companies are audited annually by independent auditors, although the timing for reporting the results of such audits does not coincide with the Medical Center's annual financial statement reporting.

There is uncertainty in the valuation for alternative investments arising from factors such as lack of active markets (primary and secondary), lack of transparency into underlying holdings, and time lags associated with reporting by investee companies. As a result, there is at least a reasonable possibility that estimates will change in the near term by a material amount.

#### *Foundations*

The Foundations classify their investments as trading securities with investment income (including realized and unrealized gains and losses on investments, interest, and dividends) included in the excess of revenues over expenses unless the income is restricted by donor or law. Investments in marketable equity and debt securities and mutual funds are carried at quoted market values (fair value) of the investments at the balance sheet date. The Foundations also invest in alternative investments and report their investments on the same basis as the Medical Center, as described above.

#### **Inventories**

Inventories are valued at the lower of cost (first-in, first-out method) or market and are recorded in other current assets on the accompanying consolidated balance sheets.

#### **Property, Plant, and Equipment**

Property, plant, and equipment are stated at cost. Interest costs incurred during the construction period of major projects are capitalized as a component of the cost of these assets, and are depreciated over the estimated useful lives of the assets. The costs of repairs and maintenance are charged to expense as incurred.

Depreciation and amortization are computed on the straight-line method based on the estimated useful lives of the assets. The estimated useful lives conform to the guidelines established by the American Hospital Association. The half-year convention is used for calculating depreciation in the year of acquisition. Amortization expense related to assets recorded under capital leases is included with depreciation expense.

# Boston Children's Hospital and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

### **1. Summary of Significant Accounting Policies (continued)**

#### **Goodwill and Other Intangible Assets**

Goodwill of approximately \$18,582,000 was recorded in connection with the acquisition of BCHP during the year ended September 30, 2015, and represents the excess of purchase price over the fair value of net assets purchased. The carrying amount of goodwill was \$18,582,000 as of September 30, 2017. No impairment losses were recognized during 2017.

Other intangible assets consist of amortizable intangible assets recorded in connection with the acquisition of BCHP. Amortizable intangible assets include non-compete agreements and are amortized over seven years. The carrying amount of amortizable intangible assets was \$1,425,000 as of September 30, 2017. Amortizable intangible assets are reviewed for impairment whenever circumstances indicate that the carrying amount of an asset may not be recoverable.

In addition, other intangible assets include licensed software acquired in a ten-year software licensing arrangement, effective April 28, 2016. The asset for the software license is recognized and measured at cost, which includes the present value of the license obligation. The carrying amount of the related amortizable intangible asset was \$19,209,000 as of September 30, 2017.

#### **Original Issue Discount and Premium and Debt Issuance Costs**

Unamortized original issue discount and premium and the costs associated with the issuance of debt are amortized using the interest method over the life of the bond issue and are presented on the accompanying consolidated balance sheets as a direct deduction from or addition to the carrying amount of debt.

#### **Pledges**

Unconditional pledges, less an allowance for uncollectible amounts, are recorded as a receivable in the year made. Pledges receivable over a period greater than one year are stated at net present value.

#### **Net Assets**

The accompanying consolidated balance sheets classify net assets into three categories: unrestricted, temporarily restricted, and permanently restricted. Net assets that bear no external

# Boston Children's Hospital and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

### **1. Summary of Significant Accounting Policies (continued)**

restriction as to use or purpose are classified as unrestricted. Also included in unrestricted net assets are assets whose use is limited under debt or trust agreements and Board-designated funds for plant replacement and expansion and mission-related activities.

Net assets, which are restricted by donors or grantors as to use or purpose, are classified as either temporarily restricted or permanently restricted:

Temporarily restricted net assets are restricted by the donor or grantor, principally for the support of research; patient care; departmental support; medical education; community health services; and the acquisition of property, plant, and equipment. When a restriction expires, that is, when a stipulated time restriction ends or the purpose of the restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported on the consolidated statements of operations and changes in net assets as net assets released from restrictions.

Permanently restricted net assets represent contributions to the Medical Center, the principal of which may not be expended. Income from permanently restricted net assets may be unrestricted or restricted in accordance with the donor's request. In accordance with the laws of the commonwealth of Massachusetts, gains on permanently restricted net assets are recorded as temporarily restricted net assets until appropriated for expenditure by the Board of Trustees.

### **Net Patient Services Revenue**

Revenues are recorded during the period the health care services are provided, based upon the estimated net realizable amounts due from patients and third-party payors. Third-party payors include federal and state agencies (under Medicare, Medicaid, and other programs), managed care health plans, commercial insurance companies, and employers. Estimates of contractual allowances related to third-party payors are based upon the payment terms specified in the related contractual agreements and historical collection experience. Contractual allowances are accrued on an estimated basis in the period in which the related services are rendered. If estimated allowances are adjusted in future periods, the adjustments are recorded as changes in estimates of prior year third-party settlements. Revenues related to uninsured patients and copayment and deductible amounts for patients who have health care coverage may have discounts applied (uninsured discounts and contractual discounts).



## Boston Children's Hospital and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### **1. Summary of Significant Accounting Policies (continued)**

The Medical Center and its subsidiaries also record a provision for uncollectible accounts related primarily to uninsured accounts and copayment and deductible amounts to record the net self-pay accounts receivable at the estimated amounts expected to be collected. The provision for uncollectible accounts is based upon management's assessment of expected net collections considering economic conditions, historical experience, trends in health care coverage, and other collection indicators. Accounts receivable are reduced by an allowance for uncollectible accounts. Periodically throughout the year, management assesses the adequacy of the allowance for uncollectible accounts based upon historical write-off experience by payor category, including those amounts not covered by insurance. After satisfaction of amounts due from insurance and reasonable efforts to collect from the patient have been exhausted, the Medical Center follows established guidelines for placing certain past-due patient balances with collection agencies, subject to the terms of certain restrictions on collection efforts as determined by the Medical Center. Accounts receivable are written off after collection efforts have been followed in accordance with the Medical Center's policies.

#### **Incentive Payments for Using Electronic Health Records**

The American Recovery and Reinvestment Act of 2009 included provisions for implementing health information technology under the Health Information Technology for Economic and Clinical Health Act (HITECH). The provisions were designed to increase the use of electronic health record (EHR) technology and establish the requirements for a Medicaid incentive payment program beginning in 2011 for eligible providers that adopt and meaningfully use certified EHR technology. Medicaid incentive payments are available to providers that adopt, implement, or upgrade certified EHR technology. Providers must demonstrate meaningful use of such technology to qualify for Medicaid incentive payments.

The Medical Center accounts for HITECH incentive payments under a grant accounting model. Income from Medicaid incentive payments is recognized as revenue after the Medical Center has demonstrated that it complied with the meaningful use criteria over the entire applicable compliance period and the 12-month cost report period that will be used to determine the final incentive payment has ended. Medicaid EHR incentive payments recognized as revenue for the years ended September 30, 2017 and 2016, totaled \$4,301,000 and \$1,330,000, respectively, and are reported in other operating revenues. Income from incentive payments is subject to retrospective adjustment upon final settlement of the applicable cost report from which payments were calculated. Additionally, the Medical Center's attestation of compliance with the meaningful use criteria is subject to audit by the federal government.

# Boston Children's Hospital and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

### **1. Summary of Significant Accounting Policies (continued)**

#### **Research Grants and Contracts**

The Medical Center, through the Hospital, engages in research activities funded by grants and contracts with federal and state governments, and various private sources. Revenues associated with grants and contracts are recognized as the related costs are incurred. Research funds received in advance are reported as deferred revenue, and are recognized as earned revenue as the related research expenditures are incurred.

Recoveries of indirect costs relating to certain government grants and contracts are reimbursed at predetermined rates negotiated with government agencies. Recoveries of indirect costs relating to non-government grants are reimbursed at varying rates, depending upon sponsor policies.

#### **Royalty Settlement**

In January 2017, the Medical Center entered into a settlement agreement with a licensee of the Medical Center's intellectual property. The settlement agreement resolved a dispute related to the amount of royalties due to the Medical Center under an exclusive license agreement between the Medical Center and the licensee. The amount payable to the Medical Center of approximately \$38.5 million, less out of pocket costs attributable to litigation and other related expenses of \$4.4 million, was accounted for under the Medical Center's Intellectual Property Policy (the Policy) and reported as operating revenue. The Policy provided that a portion (30%) of royalty and license revenues were to be distributed to the inventor. Total distributions of \$10.5 million were made to the inventor during February 2017 and recognized as operating expense.

#### **Contributions**

Unrestricted contributions are recorded as operating revenue; restricted contributions are recorded as additions to restricted net asset balances. Donated securities and property are recorded at fair value as of the date of donation.

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

The consolidated statements of operations and changes in net assets include the excess of revenues over expenses as the performance indicator. Changes in unrestricted net assets which are excluded from the excess of revenues over expenses primarily include changes in net assets related to the pension adjustment, net assets released from restrictions for capital, and net unrealized gains or losses on other than trading investments.

# Boston Children's Hospital and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

### 1. Summary of Significant Accounting Policies (continued)

#### Income Taxes

The Medical Center; the Hospital; the Foundations; the P.O.; CHB Properties, Inc.; Longwood Research Institute, Inc.; and Blood Research Institute are Section 501(c)(3) organizations exempt from income taxes on related business income pursuant to Internal Revenue Code (the Code) Section 501(a)). Longwood Corporation is a Section 501(c)(2) organization exempt from income taxes on related business income pursuant to Code Section 501(a). Boston Children's Health Physicians, LLP is a limited liability partnership disregarded for tax purposes. Boston Children's Health International, LLC is a single member limited liability corporation disregarded for tax purposes. The open tax years for the Medical Center and its affiliated organizations are tax years ending September 30, 2014 through September 30, 2017.

#### New Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers (Topic 606)*. The core principle of ASU 2014-09 is that an entity should recognize 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. The guidance in ASU 2014-09 supersedes the FASB's current revenue recognition requirements in Accounting Standards Codification (ASC) 605, *Revenue Recognition*, and most industry-specific guidance. The provisions of ASU 2014-09 are effective for the Medical Center for the fiscal year ending September 30, 2019. The Medical Center is currently evaluating the potential effect of the adoption of this standard on the consolidated financial statements.

In August 2014, the FASB issued ASU 2014-15, *Presentation of Financial Statements – Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern*, that will require management of public and non-public companies to evaluate and disclose where there is substantial doubt about an entity's ability to continue as a going concern. The Medical Center adopted this standard for the fiscal year ending September 30, 2017. The adoption of this ASU did not have a material effect on the Medical Center's consolidated financial statements.

# Boston Children's Hospital and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

### 1. Summary of Significant Accounting Policies (continued)

In May 2015, the FASB issued ASU 2015-07, *Disclosures for Investments in Certain Entities that Calculate Net Asset Value Per Share (or its Equivalent)*. ASU 2015-07 removes the requirement to categorize within the fair value hierarchy investments for which fair values are estimated using the net asset value practical expedient provided by ASC 820, *Fair Value Measurement*. Disclosures about investments in certain entities that calculate net asset value per share are limited under ASU 2015-07 to those investments for which the entity has elected to estimate the fair value using the net asset value practical expedient. ASU 2015-07 is effective for the Medical Center for the fiscal year ending September 30, 2019, with retrospective application to all periods presented.

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments – Overall (Subtopic 825-10)*, that will require business-oriented health care not-for-profit (NFP) entities to measure equity investments that do not result in consolidation and are not accounted for under the equity method at fair value and recognize any changes in fair value in the performance indicator, unless the investments qualify for a new practicability exception. This standard precludes health care NFPs from recognizing unrealized holding gains and losses on equity securities currently classified as other than trading separately from the performance indicator. The provisions of ASU 2016-01 are effective for the Medical Center for the fiscal year ending September 30, 2020. Early application is permitted for all entities. The Medical Center is in the process of evaluating the impact of ASU 2016-01 on its consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*. The core principle of ASU 2016-02 is that lessees will recognize assets and liabilities for most leases as either finance or operating leases. The guidance in ASU 2016-02 supersedes the FASB's current lease guidance in ASC 840, *Leases*, and most industry-specific guidance. The provisions of ASU 2016-02 are effective for the Medical Center for the fiscal year ending September 30, 2020. Early application is permitted for all entities. The Medical Center is in the process of evaluating the impact of ASU 2016-02 on its consolidated financial statements.

In August 2016, the FASB issued ASU No. 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. ASU 2016-14 will change certain financial statement requirements for NFP entities in an effort to make the information more meaningful to users and make reporting less complex for NFPs. The provisions of ASU 2016-14 are effective for the Medical Center for the fiscal year ending September 30, 2019. Early application is permitted for all entities. The Medical Center is in the process of evaluating the impact of ASU 2016-14 on its consolidated financial statements.

## Boston Children's Hospital and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 1. Summary of Significant Accounting Policies (continued)

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows – Classification of Certain Cash Receipts and Cash Payments*, which addresses the following eight specific cash flow issues in order to limit diversity in practice: debt prepayment or debt extinguishment costs; settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing; contingent consideration payments made after a business combination; proceeds from the settlement of insurance claims; proceeds from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies; distributions received from equity method investees; beneficial interests in securitization transactions; and separately identifiable cash flows and application of the predominance principle. The provisions of ASU 2016-15 are effective for the Medical Center for the fiscal year ending September 30, 2020. Early adoption is permitted. The Medical Center is in the process of evaluating the impact of 2016-15 on its consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18, *Statement of Cash Flows – Restricted Cash*, which requires that the statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The provisions of ASU 2016-18 are effective for the Medical Center for the fiscal year ending September 30, 2020. Early adoption is permitted. The Medical Center is in the process of evaluating the impact of ASU 2016-18 on its consolidated financial statements.

In January 2017, the FASB issued ASU 2017-07, *Compensation – Retirement Benefits: Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. ASU 2017-07 addresses how employers that sponsor defined benefit pension and/or other postretirement benefit plans present the net periodic benefit cost in the income statement. Employers will be required to present the service cost component of net periodic benefit cost in the same income statement line item as other employee compensation costs arising from services rendered during the period. Employers will present the other components of the net periodic benefit cost separately from the line item that includes the service cost and outside of any subtotal of operating income, if one is presented. The standard is effective for the Medical Center for the fiscal year ending September 30, 2020. Early adoption is permitted. Adoption of ASU 2017-07 will require the Medical Center to include the service cost component of net periodic benefit cost related to its cash balance defined benefit plan and other postretirement benefit plan (cost of \$53,157 for 2017)

## Boston Children's Hospital and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 1. Summary of Significant Accounting Policies (continued)

within salaries and benefits on the consolidated statements of operations and changes in net assets and to present all other components (benefit of \$6,793 for 2017) as a separate line item outside of the gain from operations. Total net periodic benefit cost is recorded currently as a component of salaries and benefits on the consolidated statements of operations and changes in net assets.

#### 2. Investments and Other Assets Whose Use Is Limited

Investments and other assets whose use is limited consist of the following:

	<b>September 30</b>	
	<b>2017</b>	<b>2016</b>
	<i>(In Thousands)</i>	
Pooled investments:		
Cash and cash equivalents	\$ 22,151	\$ 19,712
Equity securities	1,410,819	1,213,560
Fixed income securities	528,769	464,348
Alternative investments	1,740,108	1,602,762
Total pooled investments	3,701,847	3,300,382
Non-pooled investments:		
Cash equivalents	535,528	239,855
Mutual funds	242,062	192,186
Equity securities	388,725	359,832
Fixed income securities	417,043	404,491
Real estate	226,949	234,543
Other	52,859	53,802
Total non-pooled investments	1,863,166	1,484,709
Long-term debt agreements (money market funds)	2,568	2,517
Externally administered trusts (marketable debt and equity securities)	49,540	47,881
Other	9,114	8,616
Total investments and other assets whose use is limited	\$ 5,626,235	\$ 4,844,105

## Boston Children's Hospital and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 2. Investments and Other Assets Whose Use Is Limited (continued)

Individual investment holdings within the alternative investments include non-marketable and market-traded debt, equity and real asset securities, and interests in other alternative investments.

The Medical Center may be exposed indirectly to securities lending; short sales of securities; and trading in futures and forward contracts, options, and other derivative products. Alternative investments often have liquidity restrictions under which the Medical Center's capital may be divested only at specified times. The Medical Center's liquidity restrictions may be up to seven years or longer for certain private equity investments. Liquidity restrictions may apply to all or portions of a particular invested amount.

Investments and other assets whose use is limited are presented on the accompanying consolidated balance sheets as follows:

	<b>September 30</b>	
	<b>2017</b>	<b>2016</b>
	<i>(In Thousands)</i>	
Investments, unrestricted as to use	<b>\$ 2,154,900</b>	\$ 1,838,046
Investments and other assets whose use is limited:		
By Board designation for plant replacement and expansion and mission-related activities	<b>2,646,645</b>	2,228,760
By donor-imposed restriction	<b>615,990</b>	572,351
By long-term debt agreements	<b>2,568</b>	2,517
For deferred compensation and other benefit obligations	<b>152,772</b>	150,815
By externally administered trusts	<b>49,540</b>	47,881
Other:		
As funds held for others	<b>1,243</b>	1,162
Other	<b>2,577</b>	2,573
	<b>3,820</b>	3,735
Total investments and other assets whose use is limited	<b>\$ 5,626,235</b>	\$ 4,844,105

Boston Children's Hospital and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**2. Investments and Other Assets Whose Use Is Limited (continued)**

Investment earnings were reported as follows:

	<b>Unrestricted</b>	<b>Temporarily Restricted</b>	<b>Total</b>
	<i>(In Thousands)</i>		
<b>Year ended September 30, 2017</b>			
Interest and dividend income:			
Operating revenue	\$ 5,956	\$ –	\$ 5,956
Non-operating revenue	57,438	–	57,438
Decrease in temporarily restricted net assets	–	(536)	(536)
Increase in value of alternative investments	137,097	23,671	160,768
Net realized gains	93,773	15,745	109,518
Recognition of unrealized losses	(7,730)	(1,587)	(9,317)
Net unrealized gains (losses) on other than trading securities	133,962	(2,317)	131,645
Net unrealized gains on trading securities	33,605	–	33,605
Total net gains on investments	<u>\$ 454,101</u>	<u>\$ 34,976</u>	<u>\$ 489,077</u>

Investment income is reported net of fees of \$9,251,000 for the year ended September 30, 2017.



## Boston Children's Hospital and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 2. Investments and Other Assets Whose Use Is Limited (continued)

Investment earnings were reported as follows:

	Unrestricted	Temporarily Restricted	Total
	<i>(In Thousands)</i>		
<b>Year ended September 30, 2016</b>			
Interest and dividend income:			
Operating revenue	\$ 5,225	\$ –	\$ 5,225
Non-operating revenue	37,073	–	37,073
Increase in temporarily restricted net assets	–	779	779
Increase in value of alternative investments	97,959	16,486	114,445
Net realized gain	47,605	5,298	52,903
Recognition of unrealized losses	(27,188)	(5,535)	(32,723)
Net unrealized gains on other than trading securities	122,866	6,353	129,219
Net unrealized gains on trading securities	10,011	–	10,011
Total net gains on investments	\$ 293,551	\$ 23,381	\$ 316,932

Investment income is reported net of fees of \$8,326,000 for the year ended September 30, 2016.

The Medical Center retains professional investment managers for the management of all pooled investments. These managers invest in temporary cash investments, fixed income securities, and equities. In addition, as part of their investment strategy, certain managers may engage in short-selling and futures and options trading. Management believes that the risk of accounting loss associated with short-selling and futures and options-trading strategies is no greater than that associated with other investment strategies, which do not involve off-balance sheet risk.

Management continually reviews its investment portfolio where the fair value is below cost, and in cases where the decline is considered to be other than temporary, an adjustment is recorded to realize the loss. The Medical Center recorded a realized loss for other-than-temporary declines in the fair value of investments of approximately \$9,317,000 and \$32,723,000 for the years ended September 30, 2017 and 2016, respectively, of which \$7,730,000 and \$27,188,000 is included in unrestricted investment income, and \$1,587,000 and \$5,535,000 is included in changes in temporarily restricted net assets. There were no investments that had aggregate gross unrealized losses at September 30, 2017 or 2016.

## Boston Children's Hospital and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 3. Contributions

Contributions received and pledged to the Medical Center were as follows:

	<b>Year Ended September 30</b>	
	<b>2017</b>	<b>2016</b>
	<i>(In Thousands)</i>	
Gross contributions	\$ 82,727	\$ 107,821
Provision for uncollectible pledges	(488)	(2,392)
Amortization of discount	(252)	(930)
Net contributions	<u>\$ 81,987</u>	<u>\$ 104,499</u>

These contributions are reported in the accompanying consolidated financial statements in accordance with donors' restrictions as follows:

	<b>Year Ended September 30</b>	
	<b>2017</b>	<b>2016</b>
	<i>(In Thousands)</i>	
Unrestricted contributions	\$ 23,156	\$ 21,445
Temporarily restricted	44,766	63,165
Permanently restricted	14,065	19,889
Net contributions	<u>\$ 81,987</u>	<u>\$ 104,499</u>

In addition to the \$82,727,000 in gross contributions raised for the year ended September 30, 2017, the Medical Center raised \$45,459,000 in non-governmental grant awards, to bring the total funds raised to \$128,186,000. In addition to the \$107,821,000 in gross contributions raised for the year ended September 30, 2016, the Medical Center raised \$29,405,000 in non-governmental grant awards, to bring the total funds raised to \$137,226,000.

## Boston Children's Hospital and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 3. Contributions (continued)

Contributions pledged to the Medical Center are due as follows:

	<b>September 30</b>	
	<b>2017</b>	<b>2016</b>
	<i>(In Thousands)</i>	
Due in less than one year	\$ 34,513	\$ 40,130
Due in one to five years	75,142	84,279
Due in more than five years	15,128	22,148
	124,783	146,557
Less discount to present value	(10,452)	(10,677)
Less allowance for uncollectible pledges	(6,228)	(7,581)
Total pledges receivable, net	108,103	128,299
Less current portion of pledges receivable, net	(32,791)	(40,130)
Non-current portion of pledges receivable, net	\$ 75,312	\$ 88,169

#### 4. Free Care, Health Safety Net Trust, and Community Services

The Medical Center's commitment to community service is evidenced by services provided to the poor and benefits provided to the broader community. Services provided to the poor include services provided to persons who are uninsured or underinsured without expectation of payment or at amounts less than established rates.

The Medical Center provides quality medical care regardless of race, creed, sex, sexual orientation, national origin, handicap, age, or ability to pay. Although reimbursement for services rendered is critical to the operations and stability of the Medical Center, it is recognized that not all individuals possess the ability to pay for essential medical services and that the Medical Center's mission is to serve the community with respect to health care and health care education.

In keeping with the Medical Center's commitment to serve members of the community, the Medical Center provides the following: charity care to the indigent, care to persons covered by governmental programs at below cost, and health care activities and programs to support the community. These activities include wellness programs, community education programs, health screenings, and a broad variety of community support services.

## Boston Children's Hospital and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### **4. Free Care, Health Safety Net Trust, and Community Services (continued)**

The Medical Center also provides resources to support numerous initiatives aimed at contributing to the physical and psychological well-being of children, youth, and families living in the Medical Center's community. These initiatives include programs at the Medical Center, and in collaboration with community-based organizations, provide comprehensive services to adolescent mothers and children, HIV outreach services, services to reduce infant mortality, assistance to the homeless, and training and other related services to individuals with developmental disabilities. The Medical Center also provides medical services to the community through its emergency room, which operates 24 hours a day, and is available to all regardless of ability to pay.

The Medical Center makes available free care programs for qualifying patients under its charity care and financial aid policy. The Medical Center obtains additional financial information for uninsured or underinsured patients who do not qualify or have not supplied requisite information to qualify for charity care. The additional information is used by the Medical Center in determining whether to qualify patients for charity care and/or financial aid. For patients who were determined by the Medical Center to have the ability to pay but did not, the uncollected amounts are reported as a component of provision for uncollectible accounts. The costs of uncompensated care (other than uncollectible accounts) and community benefit activities are derived from various Medical Center records. Amounts for activities as reported below are based on estimated and actual data, subject to changes in estimates upon the finalization of the Medical Center's cost report, and other government filings. The amounts reported below are calculated in accordance with guidelines prescribed by the Internal Revenue Service. The net cost of charity includes the direct and indirect cost of providing charity care services, and is estimated by utilizing a ratio of cost to gross charges applied to the gross uncompensated charges associated with providing charity care.

As the Hospital and the Foundations do not pursue collection of amounts determined to qualify as free care, they are not reported as net patient services revenue. The Hospital also supports the delivery of health care services to the indigent through payments to the Health Safety Net Trust (HST), which is administered by the Commonwealth of Massachusetts.

## Boston Children's Hospital and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 4. Free Care, Health Safety Net Trust, and Community Services (continued)

The amounts of HST assessment and receipts, provision for uncollectible accounts, and free care were as follows:

	<b>Year Ended September 30</b>	
	<b>2017</b>	<b>2016</b>
	<i>(In Thousands)</i>	
HST assessment	\$ 22,896	\$ 10,101
HST receipts (net patient service revenue)	<b>(15,168)</b>	(3,850)
Net disbursements to HST	<b>7,728</b>	6,251
Provision for uncollectible accounts	<b>71,683</b>	65,264
Free care (at cost)	<b>7,343</b>	7,301
Total HST, provision, and free care	<b>\$ 86,754</b>	<b>\$ 78,816</b>

#### 5. Property, Plant, and Equipment

Property, plant, and equipment consist of the following:

	<b>September 30</b>	
	<b>2017</b>	<b>2016</b>
	<i>(In Thousands)</i>	
Land and improvements	\$ 17,105	\$ 17,139
Buildings, leasehold, and related improvements	<b>1,901,804</b>	1,816,911
Equipment	<b>841,946</b>	810,183
Construction-in-progress	<b>167,588</b>	128,663
	<b>2,928,443</b>	2,772,896
Less accumulated depreciation and amortization	<b>(1,713,921)</b>	(1,598,845)
	<b>\$ 1,214,522</b>	<b>\$ 1,174,051</b>

At September 30, 2017 and 2016, the Medical Center had commitments of approximately \$301,168,000 and \$115,675,000, respectively, to complete projects relating to capital construction and software development. Demolition costs and losses on disposition of assets incurred as part of construction site enabling activities were \$13,728,000 for the year ended September 30, 2017.

## Boston Children's Hospital and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 6. Asset Retirement Obligations

Conditional asset retirement obligations amounted to \$10,834,000 and \$13,018,000 as of September 30, 2017 and 2016, respectively. These obligations are recorded in other liabilities on the accompanying consolidated balance sheets. There are no assets that are legally restricted for purposes of settling asset retirement obligations.

During 2017 and 2016, retirement obligations incurred and settled amounted to \$2,228,000 and \$621,000, respectively. Accretion expenses of \$44,000 and \$41,000 were recorded during the years ended September 30, 2017 and 2016, respectively.

#### 7. Other Assets and Other Liabilities

Other assets consist of the following:

	<b>September 30</b>	
	<b>2017</b>	<b>2016</b>
	<i>(In Thousands)</i>	
Expected insurance recoveries for professional liability claims <i>(Note 14)</i>	\$ 63,309	\$ 52,864
Employee loans receivable	12,157	11,855
Other	4,388	4,308
	<u>\$ 79,854</u>	<u>\$ 69,027</u>

## Boston Children's Hospital and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 7. Other Assets and Other Liabilities (continued)

Other liabilities consist of the following:

	<b>September 30</b>	
	<b>2017</b>	<b>2016</b>
	<i>(In Thousands)</i>	
Estimated insured professional liability losses <i>(Note 14)</i>	<b>\$ 63,309</b>	\$ 52,864
Software license obligation	<b>21,550</b>	22,545
Accrued lease escalations	<b>17,636</b>	17,858
Non-current portion of liability for claims incurred but not reported	<b>14,399</b>	13,216
Asset retirement obligation reserve <i>(Note 6)</i>	<b>10,834</b>	13,018
Promissory notes	<b>4,779</b>	11,475
Non-current portion of lease incentive obligation	<b>6,028</b>	7,389
	<b>\$ 138,535</b>	\$ 138,365

#### 8. Leases

The Medical Center and its subsidiaries lease clinical and office space under operating leases, some of which include fixed escalation clauses. The obligations under non-cancelable leases as of September 30, 2017, are as follows (in thousands):

2018	\$ 47,191
2019	47,705
2020	48,047
2021	48,250
2022	34,231
Thereafter	72,055
Total operating leases	\$ 297,479

Rent expense was approximately \$64,228,000 and \$64,514,000 for the years ended September 30, 2017 and 2016, respectively.

## Boston Children's Hospital and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 8. Leases (continued)

The Medical Center records rent expense on a straight-line basis over the life of the lease and records accrued rent as the difference between rent expense and actual payments made. As of September 30, 2017 and 2016, the accumulated difference between rent expense and amounts paid amounted to \$17,636,000 and \$17,858,000, respectively, which is included in other liabilities on the accompanying consolidated balance sheets.

#### 9. Long-Term Debt and Mortgage Notes

Long-term debt consists of the following:

	<b>September 30</b>	
	<b>2017</b>	<b>2016</b>
	<i>(In Thousands)</i>	
Series M	<b>\$ 124,851</b>	\$ 124,785
Series N	<b>216,590</b>	216,590
Series O	<b>200,640</b>	200,640
Series P	<b>149,922</b>	150,467
Series Q	<b>50,255</b>	50,255
Series R	<b>125,350</b>	125,350
Series A (BRI)	<b>6,683</b>	7,739
Series 2017A	<b>350,000</b>	—
	<b>1,224,291</b>	875,826
Less:		
Unamortized debt issuance costs	<b>8,825</b>	6,009
Current portion of long-term debt	<b>1,200</b>	1,100
	<b>\$ 1,214,266</b>	\$ 868,717

Interest paid, exclusive of cash paid related to interest rate swaps, was \$18,765,000 and \$17,392,000 for the years ended September 30, 2017 and 2016, respectively. Interest capitalized in connection with ongoing construction projects approximated \$4,960,000 and \$903,000 in 2017 and 2016, respectively.



## Boston Children's Hospital and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### **9. Long-Term Debt and Mortgage Notes (continued)**

##### **Series M Bonds**

On November 18, 2009, the Hospital issued Series M Massachusetts Health and Education Facilities Authority (MHEFA) Revenue Bonds in the aggregate principal amount of \$126,110,000. The bond proceeds were used to reimburse and fund certain capital additions, renovations, and equipment expenditures. The bonds, with a final maturity in December 2039, were issued at a net discount in the amount of \$1,780,000 to bear interest at yields, which increase from 5.30% to 5.40% as maturities lengthen. Interest payments are due semiannually. The first annual principal payment is due in 2033. Refer to Note 17 for subsequent events related to the Series M Bonds.

##### **Series N Bonds**

On May 13, 2010, the Hospital issued Series N MHEFA Revenue Bonds in the amount of \$341,590,000. The bond proceeds redeemed MHEFA's Revenue Bonds, Children's Hospital Issue, Periodic Auction Reset Securities Series G, H, I, J, and K. The Series N Bonds were issued as Variable Rate Demand Revenue Bonds. In July 2014, \$125,000,000 was refunded by the proceeds of the Series R Bonds.

The remaining outstanding Series N Bonds have a final maturity in October 2049. On August 17, 2017, the Hospital entered into two direct purchase loan agreements with banks for the remaining outstanding Series N Bonds in the amount of \$216,590,000. The terms of the loan agreements are \$65,000,000 for a nine-year period and \$151,590,000 for a ten-year period. At the end of the nine- and ten-year periods, the Series N Bonds may be remarketed or converted to another mode under the governing loan and trust agreement. Interest on the bonds is variable based on a tax-exempt rate and was 1.52% and 1.41% for Series N-3 and N-4, respectively, on September 30, 2017. Interest payments are due monthly. The first annual principal payment is due in 2029.

##### **Series O Bonds**

On December 11, 2013, the Hospital entered into two direct purchase loan agreements with banks for the Series O Massachusetts Development Finance Agency (MDFA) Revenue Bonds in the amount of \$200,640,000. The bond proceeds redeemed a \$200,000,000 bank term loan, which was entered into on August 28, 2008. The terms of the loan agreements are \$100,640,000 for a 10-year period and \$100,000,000 for a 15-year period. Interest on the loans is variable based on a tax-exempt rate and was 1.44% and 1.46%, respectively, on September 30, 2017. Interest payments are due monthly. Principal on the loans is due at maturity in 2023 and in 2028.

## Boston Children's Hospital and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### **9. Long-Term Debt and Mortgage Notes (continued)**

##### **Series P Bonds**

On May 21, 2014, the Hospital issued Series P MDFA Revenue Bonds in the amount of \$136,685,000. The bond proceeds were used to reimburse and fund certain capital additions, renovations, and equipment expenditures. The bonds, with a final maturity in October 2046, were issued at a premium in the amount of \$15,068,000 to bear interest at yields which increase from 3.85% to 4.41% as maturities lengthen. Interest payments are due semiannually. The first annual principal payment is due in 2031.

##### **Series Q Bonds**

On July 11, 2014, the Hospital entered into a direct purchase loan agreement with a bank for the Series Q MDFA Revenue Bonds in the amount of \$50,255,000. The bond proceeds were used to reimburse and fund certain capital additions and renovations. The term of the loan agreement is for a ten-year period. Interest on the loan is variable based on a tax-exempt rate and was 1.35% on September 30, 2017. Interest payments are due monthly. Principal on the loan is due at maturity in 2024.

##### **Series R Bonds**

On July 29, 2014, the Hospital entered into a direct purchase loan agreement with a bank for the Series R MDFA Revenue Bonds in the amount of \$125,350,000. The bond proceeds redeemed \$125,000,000 of the Series N-1 and N-2 MHEFA Variable Rate Demand Revenue Bonds. The term of the loan agreement is for a 15-year period. Interest on the loan is variable based on a tax-exempt rate and was 1.44% on September 30, 2017. Interest payments are due monthly. The first annual principal payment is due in 2022, with a final payment on the loan due at maturity in 2029.

##### **Series A Bonds**

On September 1, 1992, BRI entered into a Mortgage and Trust Agreement with MHEFA for \$21,300,000 MHEFA Revenue Bonds, BRI Issue, Series A. These bonds have a fixed interest rate of 6.5%, and are due serially through February 1, 2022. The proceeds of the issue were used to finance an initial lease payment pursuant to a capital lease with Harvard College and purchased equipment. The bonds are collateralized by substantially all of BRI's assets and are guaranteed by Harvard College (the lessor), the owner of the leased property.

## Boston Children's Hospital and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### **9. Long-Term Debt and Mortgage Notes (continued)**

The bonds require semiannual interest payments on February 1 and August 1 and are redeemable prior to maturity beginning on February 1, 2003, at the option of MHEFA, and with the consent of BRI or by direction of BRI at redemption prices ranging from 100% to 102%, depending on the date they are redeemed, plus accrued interest. The bonds are also subject to redemption from required sinking fund installments.

#### **Series 2017A**

On January 31, 2017, the Hospital issued "The Children's Hospital Corporation Taxable Bonds, Series 2017A" in the amount of \$350,000,000. The proceeds will be used for general corporate purposes. The bonds, with a final maturity on January 1, 2047, bear interest at a yield of 4.12%. Interest payments are due semiannually.

#### **Mortgage Notes**

On August 1, 2008, Fenmore Realty Corporation (which merged into the Hospital on June 14, 2016) entered into a mortgage note in the amount of \$43,250,000. The note is secured by certain real estate investments. The note bears interest at a fixed rate of 6.53%, and matures in annual amounts through 2018. The annual principal and interest payments are \$3,291,000 each year through 2018, with a final principal payment of \$36,967,000 due at maturity on August 1, 2018.

On November 9, 2009, CHB Properties, Inc. acquired the remaining property interest in a medical office building and assumed the balance of the mortgage note in the amount of \$27,837,000. The note matured in 2014.

On October 1, 2013, CHB Properties, Inc. entered into a term loan with a bank in the amount of \$27,000,000 to pay off the remaining balance of the mortgage note described in the preceding paragraph. The bank loan bears interest at a variable rate of 1.66% at September 30, 2017, and is scheduled to mature on November 30, 2019. Interest payments are due monthly.

As of September 30, 2017, the Medical Center was in compliance with its debt covenants.

## Boston Children's Hospital and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 9. Long-Term Debt and Mortgage Notes (continued)

##### Future Maturities

Future maturities of long-term debt and mortgage notes as of September 30, 2017 are as follows:

	Series A Bonds	Series M Bonds	Series N Bonds	Series O Bonds	Series P Bonds	Series Q Bonds	Series R Bonds	2017A Bonds	Mortgage Notes	Total
Years ending										
September 30:										
2018	\$ 1,200	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 37,416	\$ 38,616
2019	1,300	-	-	-	-	-	-	-	-	1,300
2020	1,400	-	-	-	-	-	-	-	27,000	28,400
2021	1,500	-	-	-	-	-	-	-	-	1,500
2022	1,500	-	-	-	-	-	-	-	-	1,500
Thereafter	-	126,110	216,590	200,640	136,685	50,255	125,350	350,000	-	1,205,630
Principal payments	6,900	126,110	216,590	200,640	136,685	50,255	125,350	350,000	64,416	1,276,946
Premium (discount)	(217)	(1,259)	-	-	13,237	-	-	-	-	11,761
Total	\$ 6,683	\$ 124,851	\$ 216,590	\$ 200,640	\$ 149,922	\$ 50,255	\$ 125,350	\$ 350,000	\$ 64,416	\$ 1,288,707
Less:										
Unamortized debt issuance costs										8,825
										<u>\$1,279,882</u>

##### Interest Rate Swap Agreements

The Medical Center was a party to the following interest rate swap agreements as of September 30, 2017:

Effective Date	Notional Amount	Fixed Interest Rate	Maturity Date
December 2007	\$ 120,000,000	3.42%	October 2042
May 2006	119,875,000	3.57	October 2040
August 2004	70,000,000	4.00*	October 2028
November 2003	50,000,000	3.13	October 2040
July 2002	35,000,000	4.72	October 2022
July 2002	35,000,000	4.72	October 2027
May 2001	105,250,000	4.58	October 2035

\*Fixed at 4.00% through October 1, 2028, if the variable rate tax-exempt index reaches 4.50%.

## Boston Children's Hospital and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### **9. Long-Term Debt and Mortgage Notes (continued)**

The Medical Center uses interest rate swap agreements in order to manage its interest rate risk associated with its outstanding debt. These swaps effectively convert interest rates on variable rate bonds to fixed rates. The interest rate swap agreements meet the definition of derivative instruments. Consequently, the aggregate fair value of the swaps (a liability of \$135,242,000 and \$177,094,000 at September 30, 2017 and 2016, respectively) is reported in long-term liabilities on the accompanying consolidated balance sheets, and the change in fair value of \$41,852,000 and \$(30,780,000) for the years ended September 30, 2017 and 2016, respectively, is reported as a non-operating gain or loss on the accompanying consolidated statements of operations and changes in net assets. The swaps, while serving as an economic hedge, do not qualify as an accounting hedge.

Cash flows under the swaps netted to payments of approximately \$15,063,000 and \$17,069,000 in 2017 and 2016, respectively, and are reported with interest expense on the accompanying consolidated statements of operations and changes in net assets.

Three of the interest rate swaps are cancelable at the option of the counterparty at any time if the variable interest rate is greater than or equal to 7%. The aggregate fair value of these swaps as of September 30, 2017 and 2016 is a liability of approximately \$27,082,000 and \$37,033,000, respectively.

#### **Guaranteed Debt and Other Arrangements**

As security to the Hospital's direct purchase loan agreements with banks, Series M, N, P, and 2017A bondholders, and the mortgage notes associated with Fenmore Realty Corporation and CHB Properties, Inc., the Medical Center has executed unconditional and irrevocable guaranties of full and punctual payment of all obligations of the Hospital under the terms of the related loan agreements. As part of the direct purchase loan agreements for the Series O and R Bonds, the Hospital has agreed to maintain a minimum average deposit of \$15,000,000 with a bank.

## Boston Children's Hospital and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 10. Restricted Net Assets

Temporarily restricted net assets are composed of the following:

	<b>September 30</b>	
	<b>2017</b>	<b>2016</b>
	<i>(In Thousands)</i>	
Mission-related activities	<b>\$ 260,760</b>	\$ 286,918
Accumulated gains on permanently restricted net assets	<b>257,496</b>	220,276
	<b>\$ 518,256</b>	\$ 507,194

Permanently restricted net assets are restricted as follows:

	<b>September 30</b>	
	<b>2017</b>	<b>2016</b>
	<i>(In Thousands)</i>	
Investments to be held in perpetuity, the income from which is:		
Unrestricted as to use	<b>\$ 28,382</b>	\$ 28,312
Restricted for patient care-related activities	<b>148,640</b>	142,497
Restricted for research	<b>56,907</b>	50,701
Restricted for medical education	<b>21,448</b>	19,827
	<b>\$ 255,377</b>	\$ 241,337

The Medical Center follows the requirements of the Massachusetts Uniform Prudent Management of Institutional Funds Act (UPMIFA) as they relate to its permanently restricted endowments. The Medical Center's endowments consist of numerous individual funds established for a variety of purposes and include both donor-restricted endowment funds and unrestricted Board-designated funds held as endowments. Net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

## Boston Children's Hospital and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 10. Restricted Net Assets (continued)

Management of the Medical Center has interpreted UPMIFA as requiring the preservation of the fair value of the original gift as of the date of the gift absent explicit donor stipulation to the contrary. Permanently restricted net assets are classified as (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment funds that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure. The Medical Center considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds: (1) the duration and preservation of the fund, (2) the purpose of the Medical Center and the donor-restricted endowment fund, (3) general economic conditions, (4) the possible effect of inflation and deflation, (5) the expected total return from income and the appreciation of investments, and (6) the investment policies of the Medical Center.

The components of endowment-related activities include the following:

	<b>Board- Designated Funds</b>	<b>Temporarily Restricted Funds</b>	<b>Permanently Restricted Funds</b>	<b>Total Endowment Funds</b>
	<i>(In Thousands)</i>			
<b>Year ended September 30, 2017</b>				
Endowment net assets at beginning of year	\$ 865,326	\$ 220,345	\$ 195,216	\$ 1,280,887
Investment return:				
Investment income	17,722	2,067	–	19,789
Net appreciation	116,447	49,180	–	165,627
Total investment gain	134,169	51,247	–	185,416
Contributions	7,035	–	11,949	18,984
Net asset reclassifications	282,618	–	(25)	282,593
Amounts appropriated for expenditure	(37,819)	(14,096)	–	(51,915)
Endowment net assets at end of year	\$ 1,251,329	\$ 257,496	\$ 207,140	\$ 1,715,965

\*Excluded from the above table, but included in total permanently restricted net assets for the year ended September 30, 2017, are permanently restricted pledges of \$13,373 and externally administered trusts of \$34,864.

Boston Children's Hospital and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**10. Restricted Net Assets (continued)**

	<b>Board- Designated Funds</b>	<b>Temporarily Restricted Funds</b>	<b>Permanently Restricted Funds</b>	<b>Total Endowment Funds</b>
	<i>(In Thousands)</i>			
<b>Year ended September 30, 2016</b>				
Endowment net assets at beginning of year	\$ 837,683	\$ 234,818	\$ 179,516	\$ 1,252,017
Investment return:				
Investment income	4,997	2,485	–	7,482
Net appreciation	68,245	33,306	–	101,551
Total investment gain	73,242	35,791	–	109,033
Contributions	18,208	–	12,706	30,914
Net asset reclassifications	–	–	2,994	2,994
Amounts appropriated for expenditure	(63,807)	(50,264)	–	(114,071)
Endowment net assets at end of year	<u>\$ 865,326</u>	<u>\$ 220,345</u>	<u>\$ 195,216</u>	<u>\$ 1,280,887</u>

\*Excluded from the above table, but included in total permanently restricted net assets for the year ended September 30, 2016, are permanently restricted pledges of \$11,257 and externally administered trusts of \$34,864.

The Medical Center's investment and spending policies for endowment assets are intended to provide a predictable stream of funding to programs supported by its endowment, while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the Medical Center must hold in perpetuity and the unexpended appreciation on those funds and unrestricted funds, which the Board has designated to function as endowments in support of mission-related activities. Under this policy, as approved by the Board of Trustees, the endowment assets are invested with the expectation they will generate a long-term rate of return of approximately 6.5% per annum. Actual returns in any given year may vary from this amount.



## Boston Children's Hospital and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 10. Restricted Net Assets (continued)

To satisfy its long-term rate-of-return objectives, the Medical Center 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). The Medical Center targets a diversified asset allocation that consists of equities, fixed income securities, and alternative investments.

The Medical Center has a policy of appropriating for distribution each year no more than 5.0% of its endowment funds' three-year trailing average market value. In establishing this policy, the Medical Center considered the long-term expected return on its endowments.

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 the Medical Center to retain as a fund of perpetual duration. Deficiencies of this nature that are reported in unrestricted net assets are \$0 as of September 30, 2017. The deficiency reported as of September 30, 2016 was \$1,033,864. This deficiency resulted from unfavorable market fluctuations.

The Hospital's donor match program matches certain permanently restricted gifts from donors under a predefined ratio. This program has resulted in several major gifts to the Hospital in support of certain strategic purposes.

Net assets were released from donor or grantor restrictions by incurring expenses satisfying the following restricted purposes:

	<b>Year Ended September 30</b>	
	<b>2017</b>	<b>2016</b>
	<i>(In Thousands)</i>	
Mission-related activities	\$ 63,754	\$ 66,434

## Boston Children's Hospital and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### **11. Net Patient Services Revenue**

The Hospital and the Foundations have agreements with numerous third-party payors that provide for payments at amounts different from their established charges. Contracts with commercial providers provide for payments based on a variety of methodologies, including discounted charges, per-case or per-diem arrangements, and fee schedules for certain outpatient and professional services. Medicaid payments are based on a contract with the Massachusetts Executive Office of Health and Human Services, and hospital services are reimbursed on a standardized payment-per-encounter basis for outpatients, a standardized per-adjusted-discharge basis for inpatients, and a fee schedule for professional services. Medicare reimbursements are based upon Medicare's proportionate share of reasonable costs for hospital services and a fee schedule for professional services.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Revenues from Medicare and Medicaid, including Medicaid out-of-state programs, accounted for approximately 1.0% and 16.6%, respectively, of the Medical Center's net patient services revenue for 2017. Revenues from Medicare and Medicaid, including Medicaid out-of-state programs, accounted for approximately 1.0% and 16.4%, respectively, of the Medical Center's net patient services revenue for 2016.

During 2017 and 2016, in connection with special legislative appropriations, the Medical Center received \$21,117,000 and \$20,411,000, respectively, from the Federal Children's Hospital's Graduate Medical Education program for reimbursement of graduate medical education expense. There is no guarantee that similar appropriations will occur in the future, or at what level.

Differences between estimated and final settlements are recorded as contractual adjustments in the year determined. The Medical Center decreased contractual adjustments by approximately \$6,894,000 and \$9,344,000 in 2017 and 2016, respectively, as a result of final settlements and other adjustments to prior year estimates.

## Boston Children's Hospital and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 11. Net Patient Services Revenue (continued)

The Medical Center's allowance for uncollectible accounts increased to 18% of accounts receivable at September 30, 2017 from 16% of accounts receivable at September 30, 2016. The Hospital's and Foundations' self-pay and third-party payor write-offs were \$77,251,000 and \$78,306,000 for fiscal years 2017 and 2016, respectively. Write-offs as a percentage of net patient service revenue were 4% and 4% for fiscal years 2017 and 2016, respectively. The Hospital and Foundations have not changed their charity care or uninsured discount policies during fiscal year 2017. The Hospital and the Foundations grant credit without collateral to their patients. The concentration of credit risk by payor, as measured by patient accounts receivable, net of contractual adjustments, was as follows:

	<b>Year Ended September 30</b>	
	<b>2017</b>	<b>2016</b>
Commercial/other managed care	<b>30.1%</b>	31.9%
Blue Cross	<b>16.6</b>	20.9
Medicaid	<b>16.9</b>	17.0
International	<b>26.9</b>	22.5
Patients	<b>5.6</b>	5.1
Other governmental	<b>3.9</b>	2.6
Total	<b>100.0%</b>	100.0%

## Boston Children's Hospital and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 11. Net Patient Services Revenue (continued)

Revenues from third-party payors, the uninsured, and other revenues are summarized in the following tables:

	<b>Amount</b>	<b>Percentage</b>
	<i>(In Thousands)</i>	
<b>Year ended September 30, 2017</b>		
Commercial/other managed care	\$ 789,365	38.9%
Blue Cross	626,642	30.9
Medicaid	324,101	16.0
International	147,024	7.3
Patients	52,480	2.6
Other governmental	66,615	3.3
Other	21,116	1.0
Revenues before provision for uncollectible accounts	2,027,343	100.0
Provision for uncollectible accounts	(71,683)	(3.5)
Net patient services revenue	\$ 1,955,660	96.5%
<b>Year ended September 30, 2016</b>		
Commercial/other managed care	\$ 742,104	39.4%
Blue Cross	573,866	30.4
Medicaid	298,826	15.9
International	153,523	8.1
Patients	49,711	2.6
Other governmental	47,984	2.5
Other	20,411	1.1
Revenues before provision for uncollectible accounts	1,886,425	100.0
Provision for uncollectible accounts	(65,264)	(3.5)
Net patient services revenue	\$ 1,821,161	96.5%

## Boston Children's Hospital and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### **12. Employees' Retirement Plans**

The Hospital sponsors two non-contributory, defined benefit retirement plans (the Regular Employees' Pension Plan and the Maintenance Employees' Pension Plan), which cover substantially all employees of the Hospital. The Regular Employees' Pension Plan and the Maintenance Employees' Pension Plan are cash balance plans under which benefits are based on the annuitized value of a participant's account, which consists of basic credits (determined on age, years of vesting service, and compensation), plus interest credits thereon. The measurement date of these plans is September 30. The Hospital does not provide postretirement benefits other than pension to its retirees.

The Foundations maintain eight defined benefit pension plans for eligible employees at retirement based upon years of service, age, and compensation rates near retirement. These plans call for benefits to be paid to eligible employees at retirement based upon years of service and compensation earned as set forth in each plan. Contributions to these plans reflect benefits attributed to employees' services to date, as well as services expected to be earned in the future, and are based upon actuarially determined requirements. Annual measurement dates for these respective plans are June 30 or September 30, based on their fiscal year-ends.

One of the Foundations also maintains a postretirement medical plan, which provides eligible participants and their dependents with postretirement health benefits. The plan is intended to qualify as a medical reimbursement plan under Internal Revenue Code Section 105(b). Participants must meet age and years of service requirements. A fixed amount is credited to a participant's accounts based on years of service, with a cost of living adjustment credited annually. The measurement date is June 30 for the postretirement medical plan.

Boston Children's Hospital and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**12. Employees' Retirement Plans (continued)**

**Reconciliation of Funded Status**

A reconciliation of the changes in the defined benefit pension plans' aggregate projected benefit obligation, fair value of assets, and the accumulated benefit obligation of the plans is as follows:

	<b>Year Ended September 30</b>	
	<b>2017</b>	<b>2016</b>
	<i>(In Thousands)</i>	
<b>Change in benefit obligation</b>		
Benefit obligation at beginning of year	\$ 943,834	\$ 809,003
Service cost	53,157	46,462
Interest cost	32,954	34,344
Actuarial (gain) loss	(26,224)	78,436
Plan amendments	(14,365)	1,300
Plan established	-	2,689
Settlements	-	(8,406)
Benefits paid	(34,260)	(19,994)
Benefit obligations at end of year	<u>955,096</u>	943,834
<b>Change in plan assets</b>		
Fair value of plan assets at beginning of year	772,051	715,790
Actual return on plan assets	91,491	43,968
Employer contributions	43,861	40,346
Settlements	-	(8,059)
Benefits paid	(34,260)	(19,994)
Fair value of plan assets at end of year	<u>873,143</u>	<u>772,051</u>
<b>Funded status</b>		
Net pension liability at end of year	<u>\$ (81,953)</u>	<u>\$ (171,783)</u>
Accumulated benefit obligation	<u>\$ 865,291</u>	<u>\$ 832,556</u>

Boston Children's Hospital and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**12. Employees' Retirement Plans (continued)**

	<b>As of September 30</b>	
	<b>2017</b>	<b>2016</b>
	<i>(In Thousands)</i>	
<b>Amounts not yet recognized in net periodic benefit cost and included in unrestricted net assets</b>		
Actuarial net loss	\$ 143,476	\$ 221,765
Prior service credit	(24,553)	(10,509)
	<b>\$ 118,923</b>	<b>\$ 211,256</b>

The aggregate projected benefit obligation and fair value of plan assets for defined benefit plans with benefit obligations in excess of plan assets was \$893,658,000 and \$804,244,000 as of September 30, 2017, and \$927,082,000 and \$751,808,000 as of September 30, 2016. The aggregate projected benefit obligation and fair value of plan assets for defined benefit plans with fair value of plan assets in excess of benefit obligations was \$61,438,000 and \$68,899,000 as of September 30, 2017, and \$16,752,000 and \$20,242,000 as of September 30, 2016.

	<b>Year Ended September 30</b>	
	<b>2017</b>	<b>2016</b>
	<i>(In Thousands)</i>	
<b>Components of net periodic benefit cost</b>		
Service cost	\$ 53,157	\$ 46,462
Interest cost	32,954	34,344
Expected return on plan assets	(49,592)	(49,409)
Effect of settlement	-	2,697
Plan established	-	2,689
Amortization of unrecognized net loss	10,166	5,472
Amortization of net transition obligation	-	-
Amortization of prior service credit	(321)	(321)
Net periodic benefit cost	<b>\$ 46,364</b>	<b>\$ 41,934</b>

Prior service credit of \$1,354,000 and unrecognized actuarial losses of \$4,878,000 are expected to be recognized in net periodic pension cost during the fiscal year ending September 30, 2018.

## Boston Children's Hospital and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 12. Employees' Retirement Plans (continued)

The weighted average assumptions used to develop pension expense are as follows:

	<b>Year Ended September 30</b>	
	<b>2017</b>	<b>2016</b>
Discount rates	<b>3.60%–3.70%</b>	4.35%–4.40%
Expected return on plan assets	<b>6.50%–7.00%</b>	7.00%
Rates of compensation increase	<b>2.00%–4.00%</b>	2.00%–4.00%

The weighted average assumptions used to develop the projected benefit obligation are as follows:

	<b>Year Ended September 30</b>	
	<b>2017</b>	<b>2016</b>
Discount rates	<b>3.75%–3.90%</b>	3.60%–3.70%
Rates of compensation increase	<b>2.00%–4.00%</b>	2.00%–4.00%

#### Plan Assets

To develop the expected long-term rate of return on plan assets assumption, the Medical Center considered the historical return and the future expectations for returns for each asset class, as well as the target asset allocation of the pension portfolios.

The plans' investment objectives are to achieve long-term growth in excess of long-term inflation, and to provide a rate of return that meets or exceeds the actuarial expected long-term rate of return on plan assets over a long-term time horizon. In order to minimize risk, the plans intend to minimize the variability in yearly returns. The plans also intend to diversify their holdings among asset classes, investment managers, sectors, industries, and companies. The Hospital's and Foundations' target asset policy guidelines include total equities between 45% and 75%, total fixed income between 10% and 40%, and other strategies between 5% and 25%.



## Boston Children's Hospital and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 12. Employees' Retirement Plans (continued)

The Hospital's and Foundations' pension plans' weighted average asset allocations, by asset category, are as follows:

	<b>September 30</b>	
	<b>2017</b>	<b>2016</b>
Cash and cash equivalents	2.7%	4.1%
U.S. equities	15.3	15.9
Mutual funds	6.9	7.1
Global equities	21.6	19.1
Fixed income	11.1	12.6
Alternative investments	42.4	41.2
Total	<b>100.0%</b>	<b>100.0%</b>

#### Contributions

The Hospital and Foundations expect to contribute an aggregate of approximately \$40,959,000 to their pension plans in 2018.

#### Estimated Future Benefit Payments

Benefit payments, which reflect expected future service, are expected to be paid as follows (in thousands):

	<b>Pension Benefits</b>
2018	\$ 58,848
2019	50,563
2020	57,446
2021	64,928
2022	67,706
Years 2023–2028	375,680

## Boston Children's Hospital and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### **12. Employees' Retirement Plans (continued)**

Certain physicians, by virtue of their joint appointments at the Hospital and Harvard University, are eligible for participation in the Harvard Retirement Plan for Teaching Faculty (the Harvard Plan), a defined contribution plan, and do not participate in the Hospital's plans. The Hospital's pension expense related to the Harvard Plan was approximately \$4,383,000 and \$4,133,000 for the years ended September 30, 2017 and 2016, respectively.

The Hospital has a 403(b) Tax-Deferred Annuity Plan under which contributions can be made by employees. The Hospital makes contributions to the plan based on a percentage of annual eligible earnings. Hospital contributions under the plan amounted to \$6,635,000 and \$5,559,000 for the years ended September 30, 2017 and 2016, respectively.

The Foundations have established 18 defined contribution plans to provide their long-term physician employees with fair and adequate retirement benefits. These include traditional 403(b) plans, money purchase plans, and profit-sharing plans. The basis for determining contributions range from 7.8% to 25% based on compensation of eligible employees. Total expense recognized by the Foundations under the defined contribution plans for the years ended September 30, 2017 and 2016 amounted to \$30,088,000 and \$28,549,000, respectively.

#### **13. Deferred Compensation and Other Benefit Obligations**

The Medical Center and Foundations maintain a program of integrated retirement plans such as 457(b), 457(f), and supplemental executive retirement plans to provide supplemental retirement benefits to certain employees. Plans provide either immediate vesting of benefits or may be determined by years of service and annual base compensation depending on the provisions set for the respective plans.

The Foundations have also established other profit-sharing, severance benefit, education or tuition, and long-term service plans to provide their physician employees with fair and adequate benefits. The benefits under these plans are administered based on the provisions set forth in the respective plan documents.

## Boston Children's Hospital and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 13. Deferred Compensation and Other Benefit Obligations (continued)

The following table outlines the assets designated, accrued liabilities, and expenses recorded for the respective deferred compensation and other benefit plans as of and for the years ended September 30:

	<b>Assets</b>	<b>Liabilities</b>	<b>Expense</b>
	<i>(In Thousands)</i>		
<b>2017</b>			
Supplemental retirement benefit plans	\$ 82,577	\$ 96,124	\$ 14,412
Other benefit plan obligations	70,195	32,135	7,353
	\$ 152,772	\$ 128,259	\$ 21,765
<b>2016</b>			
Supplemental retirement benefit plans	\$ 77,667	\$ 91,365	\$ 14,549
Other benefit plan obligations	73,148	41,378	11,912
	\$ 150,815	\$ 132,743	\$ 26,461

#### 14. Professional Liability

The Hospital's and the Foundations' primary professional and general liability insurance coverages are provided by Controlled Risk Insurance Company, Ltd. (CRICO), a corporation formed and wholly owned by the Harvard-affiliated medical institutions. The Hospital owns approximately 10% of CRICO's stock and accounts for this investment on the cost basis. The premiums paid to CRICO are actuarially determined based on asserted claims and incurred but unasserted, claims. CRICO obtains excess coverage from other insurers.

The Hospital's and the Foundations' professional liability insurance policy is a retrospectively rated policy and is on a claims-made basis. The Hospital and the Foundations accrue a liability for claims incurred but not reported which, at September 30, 2017, was \$14,399,000 and, at September 30, 2016, was \$13,272,000. Additionally, the Hospital and Foundations recorded a liability of \$63,309,000 and \$52,864,000 at September 30, 2017 and 2016, respectively, related to estimated insured professional liability losses and a corresponding receivable of \$63,309,000 and \$52,864,000 at September 30, 2017 and 2016, respectively, related to estimated recoveries under insurance coverage for recoveries of the potential losses.

## Boston Children's Hospital and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 14. Professional Liability (continued)

Professional liability insurance expenses, net of recoveries, are as follows:

	Year Ended September 30	
	2017	2016
	<i>(In Thousands)</i>	
Professional liability insurance premiums, net of recoveries	\$ 11,081	\$ 13,791
Decrease in reserve for incurred but not reported professional liability claims	(177)	(1,455)
Total	<u>\$ 10,904</u>	<u>\$ 12,336</u>

#### 15. Fair Value of Financial Instruments

The Medical Center uses the methods for calculating fair value as defined in ASC 820, *Fair Value Measurement*, to value its financial assets and liabilities, where applicable. ASC 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, and establishes a framework for measuring fair value. Fair value measurements are applied based on the unit of account from the reporting entity's perspective.

The unit of account determines what is being measured by reference to the level at which the asset or liability is aggregated (or disaggregated) for purposes of applying other accounting pronouncements.

ASC 820 establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy is based upon 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: Quoted prices (unadjusted) in active markets that are accessible at the measurement date for identical assets or liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.

Level 2: Observable inputs that are based on inputs not quoted in active markets, but corroborated by market data.

## Boston Children's Hospital and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 15. Fair Value of Financial Instruments (continued)

Level 3: Unobservable inputs are used when little or no market data is available. The fair value hierarchy gives the lowest priority to Level 3 inputs.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. In determining fair value, the Medical Center uses valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible, and considers non-performance risk in its assessment of fair value.

These financial instruments exclude real estate and investments accounted for under the equity method of approximately \$1,964,916,000 and \$1,891,107,000 at September 30, 2017 and 2016, respectively.

Financial instruments carried at fair value are classified in the table below in one of the three categories described above:

	September 30, 2017			
	Level 1	Level 2	Level 3	Total
	<i>(In Thousands)</i>			
<b>Assets</b>				
Cash and cash equivalents	\$ 527,391	\$ 218,429	\$ –	\$ 745,820
U.S. equities	756,413	143,331	–	899,744
Global equities	196,919	453,730	204,330	854,979
Investment-grade fixed income	46,066	650,074	–	696,140
Mutual funds	202,878	38,166	–	241,044
High-yield fixed income	–	59,573	–	59,573
Global bonds fixed income	–	48,431	–	48,431
Real asset funds	55,472	60,116	–	115,588
	\$ 1,785,139	\$ 1,671,850	\$ 204,330	\$ 3,661,319
<b>Liabilities</b>				
Interest rate swap agreements	\$ –	\$ 135,242	\$ –	\$ 135,242

Boston Children's Hospital and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**15. Fair Value of Financial Instruments (continued)**

	<b>September 30, 2016</b>			
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
	<i>(In Thousands)</i>			
<b>Assets</b>				
Cash and cash equivalents	\$ 251,127	\$ 136,902	\$ –	\$ 388,029
U.S. equities	684,434	125,648	–	810,082
Global equities	143,148	378,294	133,428	654,870
Investment-grade fixed income	40,679	639,440	–	680,119
Mutual funds	169,098	30,969	–	200,067
High-yield fixed income	–	56,704	–	56,704
Global bonds fixed income	–	47,534	–	47,534
Real asset funds	58,856	56,737	–	115,593
	<u>\$ 1,347,342</u>	<u>\$ 1,472,228</u>	<u>\$ 133,428</u>	<u>\$ 2,952,998</u>
<b>Liabilities</b>				
Interest rate swap agreements	\$ –	\$ 177,094	\$ –	\$ 177,094

The following table sets forth a summary of changes in the fair value of the Level 3 assets:

	<b>Year Ended September 30</b>	
	<b>2017</b>	<b>2016</b>
	<i>(In Thousands)</i>	
Balance, beginning of year	\$ 133,428	\$ 62,510
Net realized loss	–	(2,049)
Unrealized gains relating to investments still held at the reporting date	41,349	5,967
Purchases	32,000	67,000
Sales	(2,447)	–
Balance, end of year	<u>\$ 204,330</u>	<u>\$ 133,428</u>

## Boston Children's Hospital and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 15. Fair Value of Financial Instruments (continued)

Financial assets invested in the Medical Center's defined benefit pension plans are classified in the table below in one of the three categories described above:

	September 30, 2017			
	Level 1	Level 2	Level 3	Total
	<i>(In Thousands)</i>			
<b>Assets</b>				
Cash and cash equivalents	\$ 6,545	\$ 16,560	\$ –	\$ 23,105
U.S. equities	77,643	50,397	5,937	133,977
Mutual funds	53,231	7,215	–	60,446
Global equities	53,028	82,478	52,993	188,499
Investment-grade fixed income	7,475	58,487	3,898	69,860
High-yield fixed income	2,043	13,237	–	15,280
Global bonds fixed income	–	11,188	966	12,154
Real asset funds	9,955	18,049	–	28,004
Domestic equity hedge funds	–	–	115,675	115,675
Distressed debt hedge funds	–	–	68,288	68,288
Multistrategy hedge funds	–	–	36,432	36,432
Global equity hedge funds	–	–	18,452	18,452
Private equity partnerships	–	–	102,971	102,971
	\$ 209,920	\$ 257,611	\$ 405,612	\$ 873,143

Boston Children's Hospital and Subsidiaries

Notes to Consolidated Financial Statements (continued)

15. Fair Value of Financial Instruments (continued)

	September 30, 2016			
	Level 1	Level 2	Level 3	Total
	<i>(In Thousands)</i>			
<b>Assets</b>				
Cash and cash equivalents	\$ 5,226	\$ 26,797	\$ –	\$ 32,023
U.S. equities	77,126	41,149	4,288	122,563
Mutual funds	47,169	7,336	–	54,505
Global equities	44,929	67,709	34,643	147,281
Investment-grade fixed income	10,020	59,028	2,949	71,997
High-yield fixed income	1,925	12,236	–	14,161
Global bonds fixed income	–	10,539	950	11,489
Real asset funds	10,182	16,280	–	26,462
Domestic equity hedge funds	–	–	100,259	100,259
Distressed debt hedge funds	–	–	62,928	62,928
Multistrategy hedge funds	–	–	33,342	33,342
Global equity hedge funds	–	–	14,394	14,394
Private equity partnerships	–	–	80,647	80,647
	<u>\$ 196,577</u>	<u>\$ 241,074</u>	<u>\$ 334,400</u>	<u>\$ 772,051</u>

The following table sets forth a summary of changes in the fair value of the Level 3 assets:

	Year Ended September 30	
	2017	2016
	<i>(In Thousands)</i>	
Balance, beginning of year	\$ 334,400	\$ 310,805
Net realized gain	578	5,410
Unrealized gains relating to investments still held at the reporting date	56,606	6,370
Purchases	15,774	41,162
Sales	(1,746)	(29,347)
Balance, end of year	<u>\$ 405,612</u>	<u>\$ 334,400</u>



## Boston Children's Hospital and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 15. Fair Value of Financial Instruments (continued)

The following table presents liquidity information for the financial instruments carried at net asset value:

Investment Type	September 30		Liquidity Restriction Range (Including Notice Period) for Redemption*
	2017	2016	
	Net Asset Value	Net Asset Value	
<i>(In Thousands)</i>			
U.S. equities	\$ 62,673	\$ 52,080	0 to 60 days
Global equities	134,179	101,278	30 to over 365 days
Cash and cash equivalents	16,561	26,803	0 to 30 days
Investment-grade fixed income	61,764	61,380	0 to 30 days
High-yield fixed income	13,237	12,236	0 to 30 days
Global bonds fixed income	10,971	10,327	0 to 30 days
Real asset funds	18,664	16,895	0 to 60 days
Domestic equity hedge funds	113,615	98,491	90 to over 365 days
Distressed debt hedge funds	67,403	62,104	90 to over 365 days
Multistrategy hedge funds	36,432	33,342	90 to over 365 days
Global equity hedge funds	18,452	14,393	90 to over 365 days
Private equity partnerships	102,971	80,647	Up to 7 years
	<u>\$ 656,922</u>	<u>\$ 569,976</u>	

\*Notices for redemption can be anywhere from a few days before a redemption date to more than 90 days, assuming the fund has met its lockup period.

Assets classified as Level 1 are valued using unadjusted quoted market prices for identical assets in active markets. Level 2 assets include U.S. and global equities, fixed income securities, and real asset funds. Fair value for Level 2 assets is based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets. Inputs are obtained from various sources, including market participants, dealers, and brokers. Fair value for Level 3 assets is determined using net asset values as a practical expedient, as permitted by generally accepted accounting principles, rather than using another valuation method to independently estimate fair value. There were no transfers between Level 1 and Level 2 during fiscal year 2017.

## Boston Children's Hospital and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### **15. Fair Value of Financial Instruments (continued)**

The Level 2 liabilities are interest rate swap agreements. The fair value of interest rate swap agreements is primarily determined using techniques consistent with the market approach. Significant observable inputs to valuation models include interest rates, Treasury yields, and credit spreads.

The Medical Center's long-term debt obligations and mortgage notes are reported on the accompanying consolidated balance sheets at principal value, less unamortized discount or premium and debt issuance costs, which totaled approximately \$1,215,466,000 and \$64,416,000, respectively, at September 30, 2017. The fair value of the long-term obligations and mortgage notes was \$1,261,723,000 and \$65,274,000, respectively, at September 30, 2017. The Medical Center's long-term debt obligations and mortgage notes are reported on the accompanying consolidated balance sheets at principal value, less unamortized discount or premium and debt issuance costs, which totaled approximately \$869,817,000 and \$65,235,000, respectively, at September 30, 2016. The fair value of the long-term obligations and mortgage notes was \$898,193,000 and \$67,062,000, respectively, at September 30, 2016.

Such fair value was determined assuming that the carrying value of the variable rate debt approximated fair value. The fair value of fixed rate debt was determined using discounted cash flows at current interest rates. These methodologies are consistent with the classification of Level 2 in the fair value hierarchy.

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

## Boston Children's Hospital and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 16. Functional Expenses

The Medical Center is a multifaceted pediatric patient care provider dedicated to the improvement of the quality of life for children and their families. In its leadership role in pediatric medicine, the Medical Center focuses its efforts in three major areas: patient care, research, and medical education. Expenses related to providing these services are estimated as follows:

	<b>Year Ended September 30</b>	
	<b>2017</b>	<b>2016</b>
	<i>(In Thousands)</i>	
Patient care	\$ 1,976,281	\$ 1,822,772
Research	383,826	371,984
Medical education	45,413	43,885
Total expenses	<u>\$ 2,405,520</u>	<u>\$ 2,238,641</u>

#### 17. Subsequent Events

In December 2017, the Hospital entered into a direct purchase loan agreement with a bank for the Series S MDFA Revenue Bonds in the amount of \$135,215,000. The proceeds were deposited into an escrow fund held by an independent trustee to advance refund the \$126,110,000 of Series M bonds on December 1, 2019, the earliest date the bonds are redeemable, and to pay the interest on the Series M Bonds through December 1, 2019. The Series S Bonds have a stated maturity of December 2039, with the first principal payment due in 2033. The Series S Bonds were issued in direct purchase mode at a fixed, tax-exempt interest rate, and the purchasing bank agreed to hold the bonds for ten years. At the end of that ten-year period, the Series S Bonds may be remarketed or converted to another mode under the governing loan and trust agreement.

Subsequent events have been evaluated for potential recognition in the consolidated financial statements through January 12, 2018, which is the date the accompanying consolidated financial statements were issued. No additional subsequent events have occurred that require disclosure in or adjustment to the consolidated financial statements.

# Supplementary Information



Ernst & Young LLP  
200 Clarendon Street  
Boston, MA 02116

Tel: +1 617 266 2000  
Fax: +1 617 266 5843  
ey.com

## Report of Independent Auditors on Supplementary Information

The Board of Trustees  
Boston Children's Hospital

We have audited, in accordance with auditing standards generally accepted in the United States, the consolidated financial statements of Children's Medical Center Corporation and Subsidiaries as of and for the years ended September 30, 2017 and 2016, and have issued an unmodified opinion thereon dated January 12, 2018. Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. We did not audit the financial statements of the Physician's Organization at Children's Hospital, Inc. (the P.O.) and the Physician Foundations (the Foundations), controlled affiliates, which statements reflect total assets of \$1,273 million and \$1,171 million and total revenues of \$702 million and \$675 million as of and for the years ended September 30, 2017 and 2016, respectively, of the related consolidated totals. The accompanying consolidating balance sheets and consolidating statements of operations as of and for the years ended September 30, 2017 and 2016, are presented for the purposes of additional analysis and are 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, based on our audits and the report of the other auditors, the information is fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.

*Ernst & Young LLP*

January 12, 2018

# Boston Children's Hospital and Subsidiaries

## Consolidating Balance Sheet

September 30, 2017

(In Thousands)

	Children's Hospital	Children's Medical Center	Obligated to the Payment of the Bonds	Physician Organization at Children's Hospital, Inc. and Foundations	Other Subsidiaries	Eliminations	Children's Medical Center Consolidated
<b>Assets</b>							
<b>Current assets:</b>							
Cash and cash equivalents	\$ 555	\$ 42,530	\$ 43,085	\$ 152,357	\$ 1,976	\$ (24,534)	\$ 172,884
Patient accounts receivable, net of allowance for uncollectible accounts	217,446	–	217,446	68,935	16,387	–	302,768
Other receivables	56,753	15,243	71,996	11,745	2,777	(40,901)	45,617
Grants receivable	52,072	–	52,072	–	–	–	52,072
Due from Children's Hospital	–	–	–	18,796	–	(18,796)	–
Due from Parent	2,524,265	(2,357,767)	166,498	–	(166,498)	–	–
Current portion of pledges receivable, net	51,092	–	51,092	–	–	(18,301)	32,791
Other current assets	53,929	543	54,472	4,676	2,210	(1,854)	59,504
<b>Total current assets</b>	<b>2,956,112</b>	<b>(2,299,451)</b>	<b>656,661</b>	<b>256,509</b>	<b>(143,148)</b>	<b>(104,386)</b>	<b>665,636</b>
<b>Investments:</b>							
Unrestricted as to use	9,074	1,056,335	1,065,409	666,491	217,558	205,442	2,154,900
Limited by Board designation	85,990	1,960,215	2,046,205	121,173	–	479,267	2,646,645
Restricted by donor-imposed restriction	1,112,486	192,989	1,305,475	24,874	–	(714,359)	615,990
	1,207,550	3,209,539	4,417,089	812,538	217,558	(29,650)	5,417,535
<b>Other assets whose use is limited:</b>							
By externally administered trusts	49,540	–	49,540	–	–	–	49,540
For deferred compensation and other benefit obligations	2,700	–	2,700	150,072	–	–	152,772
By long-term debt agreements	–	–	–	–	2,568	–	2,568
Other	6,414	–	6,414	–	–	(2,594)	3,820
	58,654	–	58,654	150,072	2,568	(2,594)	208,700
Property, plant, and equipment, net	1,055,115	5,584	1,060,699	10,024	143,799	–	1,214,522
Goodwill and identifiable intangible assets	19,209	–	19,209	–	20,007	–	39,216
Pledges receivable, net	146,470	–	146,470	–	–	(71,158)	75,312
Other assets	36,132	–	36,132	43,391	15,131	(14,800)	79,854
<b>Total assets</b>	<b>\$ 5,479,242</b>	<b>\$ 915,672</b>	<b>\$ 6,394,914</b>	<b>\$ 1,272,534</b>	<b>\$ 255,915</b>	<b>\$ (222,588)</b>	<b>\$ 7,700,775</b>

# Boston Children's Hospital and Subsidiaries

## Consolidating Balance Sheet (continued)

September 30, 2017

(In Thousands)

	Children's Hospital	Children's Medical Center	Obligated to the Payment of the Bonds	Physician Organization at Children's Hospital, Inc. and Foundations	Other Subsidiaries	Eliminations	Children's Medical Center Consolidated
<b>Liabilities and net assets</b>							
Current liabilities:							
Accounts payable and accrued expenses	\$ 134,643	\$ 3,849	\$ 138,492	\$ 18,942	\$ 8,771	\$ 12,857	\$ 179,062
Accrued salaries and wages	104,260	974	105,234	35,627	5,962	(3,771)	143,052
Current portion of estimated third-party settlement liabilities	8,830	–	8,830	–	–	(2,960)	5,870
Due to Children's Hospital	–	–	–	48,463	–	(48,463)	–
Promises to give	–	–	–	23,082	–	(23,082)	–
Current portion of long-term debt	–	–	–	–	1,200	–	1,200
Current portion of mortgage notes payable	–	–	–	–	37,416	–	37,416
Deferred revenue	108,351	–	108,351	2,298	4,581	(50,069)	65,161
Other current liabilities	1,334	–	1,334	–	5,022	–	6,356
<b>Total current liabilities</b>	<b>357,418</b>	<b>4,823</b>	<b>362,241</b>	<b>128,412</b>	<b>62,952</b>	<b>(115,488)</b>	<b>438,117</b>
Long-term liabilities:							
Long-term debt	1,208,849	–	1,208,849	–	5,417	–	1,214,266
Mortgage notes payable	–	–	–	–	27,000	–	27,000
Estimated third-party settlement liabilities	10,557	–	10,557	–	–	–	10,557
Net pension liability	67,689	–	67,689	–	–	14,264	81,953
Funds held for others	34,531	5,276	39,807	–	–	(1,925)	37,882
Interest rate swap liability	135,242	–	135,242	–	–	–	135,242
Accrued defined benefit plan obligations, net	–	–	–	14,264	–	(14,264)	–
Deferred compensation and other benefit obligations	15,369	1,303	16,672	111,587	–	–	128,259
Promises to give	–	–	–	75,121	–	(75,121)	–
Other liabilities	96,547	4,780	101,327	35,013	16,996	(14,801)	138,535
<b>Total long-term liabilities</b>	<b>1,568,784</b>	<b>11,359</b>	<b>1,580,143</b>	<b>235,985</b>	<b>49,413</b>	<b>(91,847)</b>	<b>1,773,694</b>
Net assets:							
Unrestricted	1,998,487	899,490	2,897,977	883,261	143,550	790,543	4,715,331
Temporarily restricted	780,539	–	780,539	24,876	–	(287,159)	518,256
Permanently restricted	774,014	–	774,014	–	–	(518,637)	255,377
<b>Total net assets</b>	<b>3,553,040</b>	<b>899,490</b>	<b>4,452,530</b>	<b>908,137</b>	<b>143,550</b>	<b>(15,253)</b>	<b>5,488,964</b>
<b>Total liabilities and net assets</b>	<b>\$ 5,479,242</b>	<b>\$ 915,672</b>	<b>\$ 6,394,914</b>	<b>\$ 1,272,534</b>	<b>\$ 255,915</b>	<b>\$ (222,588)</b>	<b>\$ 7,700,775</b>

See accompanying independent auditors' report on other financial information.

# Boston Children's Hospital and Subsidiaries

## Consolidating Statement of Operations

Year Ended September 30, 2017

(In Thousands)

	Children's Hospital	Children's Medical Center	Obligated to the Payment of the Bonds	Physician Organization at Children's Hospital, Inc. and Foundations	Other Subsidiaries	Eliminations	Children's Medical Center Consolidated
Revenues:							
Patient services revenue, net of contractual allowances and discounts	\$ 1,277,765	\$	\$ 1,277,765	\$ 625,439	\$ 133,009	\$ (8,870)	\$ 2,027,343
Provision for uncollectible accounts	(43,240)	–	(43,240)	(23,557)	(4,886)	–	(71,683)
Net patient services revenue	1,234,525	–	1,234,525	601,882	128,123	(8,870)	1,955,660
Research grants and contracts	217,782	–	217,782	–	–	(10,215)	207,567
Recovery of indirect costs on grants and contracts	82,293	–	82,293	–	–	(2,872)	79,421
Other operating revenue	50,076	3,959	54,035	–	41,647	10,494	106,176
Royalty settlement	–	34,082	34,082	–	–	–	34,082
Unrestricted contributions, net of fundraising expenses	15,589	–	15,589	–	–	(1,774)	13,815
Research revenue	–	–	–	45,910	–	(45,910)	–
Clinical and other revenue	–	–	–	40,135	–	(40,135)	–
Teaching, administration and supervision revenue	–	–	–	9,008	–	(9,008)	–
Net assets released from restriction used for operations	80,282	–	80,282	4,773	–	(19,771)	65,284
Total revenues	1,680,547	38,041	1,718,588	701,708	169,770	(128,061)	2,462,005
Expenses:							
Salaries and benefits	725,831	18	725,849	564,198	107,418	6,065	1,403,530
Supplies and other expenses	510,868	876	511,744	41,001	72,023	(50,918)	573,850
Costs related to royalty settlement	–	10,479	10,479	–	–	–	10,479
Direct research expenses of grants	217,782	–	217,782	–	–	(10,215)	207,567
Health Safety Net assessment	22,896	–	22,896	–	–	–	22,896
Medical service expenses	–	–	–	30,885	–	(30,885)	–
Research expenses	–	–	–	17,500	–	(17,500)	–
Contributions	–	–	–	116,805	–	(116,805)	–
Depreciation and amortization	117,909	1,097	119,006	3,316	9,906	–	132,228
Costs related to asset dispositions	9,291	–	9,291	–	4,437	–	13,728
Interest and net interest rate swap cash flows	40,592	–	40,592	–	650	–	41,242
Total expenses	1,645,169	12,470	1,657,639	773,705	194,434	(220,258)	2,405,520
Gain (loss) from operations	35,378	25,571	60,949	(71,997)	(24,664)	92,197	56,485
Non-operating gains (losses):							
Income (loss) from investments	11,042	18,075	29,117	13,649	(5,040)	19,712	57,438
Net realized gains (losses) on investments	2,699	78,735	81,434	12,372	(33)	–	93,773
Unrealized gain on investments classified as trading securities, net	–	–	–	33,605	–	–	33,605
Increase in value of alternative investments, net	3,833	91,608	95,441	21,824	–	19,832	137,097
Recognition of unrealized losses on other than trading investments	(227)	(6,518)	(6,745)	–	–	(985)	(7,730)
Fundraising expenses on restricted contributions	(21,795)	–	(21,795)	–	–	–	(21,795)
Adjustment of interest rate swaps to fair value	41,852	–	41,852	–	–	–	41,852
Other non-operating gains (losses)	2	(12,403)	(12,401)	5,195	–	(7)	(7,213)
Total non-operating gains (losses)	37,406	169,497	206,903	86,645	(5,073)	38,552	327,027
Excess (deficiency) of revenues over expenses	\$ 72,784	\$ 195,068	\$ 267,852	\$ 14,648	\$ (29,737)	\$ 130,749	\$ 383,512

See accompanying independent auditors' report on other financial information.



# Boston Children's Hospital and Subsidiaries

## Consolidating Balance Sheet

September 30, 2016

(In Thousands)

	Children's Hospital	Children's Medical Center	Obligated to the Payment of the Bonds	Physician Organization at Children's Hospital, Inc. and Foundations	Other Subsidiaries	Eliminations	Children's Medical Center Consolidated
<b>Assets</b>							
<b>Current assets:</b>							
Cash and cash equivalents	\$ 482	\$ 32,601	\$ 33,083	\$ 137,725	\$ 4,122	\$ (20,694)	\$ 154,236
Patient accounts receivable, net of allowance for uncollectible accounts	186,400	–	186,400	68,308	15,399	–	270,107
Other receivables	55,850	19,903	75,753	10,997	1,418	(37,863)	50,305
Grants receivable	39,311	–	39,311	–	–	–	39,311
Due from Children's Hospital	–	–	–	16,975	–	(16,975)	–
Due from Parent	2,112,428	(1,974,766)	137,662	–	(137,662)	–	–
Current portion of pledges receivable, net	41,730	–	41,730	–	–	(1,600)	40,130
Other current assets	36,900	170	37,070	4,771	2,675	(2,293)	42,223
<b>Total current assets</b>	<b>2,473,101</b>	<b>(1,922,092)</b>	<b>551,009</b>	<b>238,776</b>	<b>(114,048)</b>	<b>(79,425)</b>	<b>596,312</b>
<b>Investments:</b>							
Unrestricted as to use	8,302	875,722	884,024	637,470	225,925	90,627	1,838,046
Limited by Board designation	82,710	1,562,447	1,645,157	67,714	–	515,889	2,228,760
Restricted by donor-imposed restriction	1,019,454	162,373	1,181,827	26,691	–	(636,167)	572,351
	1,110,466	2,600,542	3,711,008	731,875	225,925	(29,651)	4,639,157
<b>Other assets whose use is limited:</b>							
By externally administered trusts	47,881	–	47,881	–	–	–	47,881
For deferred compensation and other benefit obligations	2,557	–	2,557	148,258	–	–	150,815
By long-term debt agreements	–	–	–	–	2,517	–	2,517
Other	6,059	–	6,059	–	–	(2,324)	3,735
	56,497	–	56,497	148,258	2,517	(2,324)	204,948
Property, plant, and equipment, net	1,016,800	6,683	1,023,483	12,345	138,223	–	1,174,051
Goodwill and identifiable intangible assets	21,469	–	21,469	–	20,307	–	41,776
Pledges receivable, net	90,139	–	90,139	–	–	(1,970)	88,169
Other assets	29,199	–	29,199	39,524	12,804	(12,500)	69,027
<b>Total assets</b>	<b>\$ 4,797,671</b>	<b>\$ 685,133</b>	<b>\$ 5,482,804</b>	<b>\$ 1,170,778</b>	<b>\$ 285,728</b>	<b>\$ (125,870)</b>	<b>\$ 6,813,440</b>

# Boston Children's Hospital and Subsidiaries

## Consolidating Balance Sheet (continued)

September 30, 2016

(In Thousands)

	Children's Hospital	Children's Medical Center	Obligated to the Payment of the Bonds	Physician Organization at Children's Hospital, Inc. and Foundations	Other Subsidiaries	Eliminations	Children's Medical Center Consolidated
<b>Liabilities and net assets</b>							
Current liabilities:							
Accounts payable and accrued expenses	\$ 126,332	\$ 1,798	\$ 128,130	\$ 28,084	\$ 9,497	\$ 8,254	\$ 173,965
Accrued salaries and wages	83,932	845	84,777	22,562	11,135	(1,270)	117,204
Current portion of estimated third-party settlement liabilities	5,221	–	5,221	–	–	(1,973)	3,248
Due to Children's Hospital	–	–	–	43,689	–	(43,689)	–
Promises to give	–	–	–	3,435	–	(3,435)	–
Current portion of long-term debt	–	–	–	–	1,100	–	1,100
Current portion of mortgage notes payable	–	–	–	–	814	–	814
Deferred revenue	98,463	–	98,463	2,824	–	(45,550)	55,737
Other current liabilities	1,339	–	1,339	–	37	–	1,376
<b>Total current liabilities</b>	<b>315,287</b>	<b>2,643</b>	<b>317,930</b>	<b>100,594</b>	<b>22,583</b>	<b>(87,663)</b>	<b>353,444</b>
Long-term liabilities:							
Long-term debt	862,158	–	862,158	–	6,559	–	868,717
Mortgage notes payable	–	–	–	–	64,421	–	64,421
Estimated third-party settlement liabilities	10,350	–	10,350	–	–	–	10,350
Net pension liability	124,207	–	124,207	–	–	47,576	171,783
Funds held for others	38,918	9,036	47,954	–	–	(2,065)	45,889
Interest rate swap liability	177,094	–	177,094	–	–	–	177,094
Accrued defined benefit plan obligations, net	–	–	–	47,577	–	(47,577)	–
Deferred compensation and other benefit obligations	13,713	979	14,692	118,051	–	–	132,743
Promises to give	–	–	–	3,810	–	(3,810)	–
Other liabilities	97,245	7,946	105,191	32,302	13,372	(12,500)	138,365
<b>Total long-term liabilities</b>	<b>1,323,685</b>	<b>17,961</b>	<b>1,341,646</b>	<b>201,740</b>	<b>84,352</b>	<b>(18,376)</b>	<b>1,609,362</b>
Net assets:							
Unrestricted	1,797,122	664,529	2,461,651	841,269	178,793	620,390	4,102,103
Temporarily restricted	630,895	–	630,895	27,175	–	(150,876)	507,194
Permanently restricted	730,682	–	730,682	–	–	(489,345)	241,337
<b>Total net assets</b>	<b>3,158,699</b>	<b>664,529</b>	<b>3,823,228</b>	<b>868,444</b>	<b>178,793</b>	<b>(19,831)</b>	<b>4,850,634</b>
<b>Total liabilities and net assets</b>	<b>\$ 4,797,671</b>	<b>\$ 685,133</b>	<b>\$ 5,482,804</b>	<b>\$ 1,170,778</b>	<b>\$ 285,728</b>	<b>\$ (125,870)</b>	<b>\$ 6,813,440</b>

See accompanying independent auditors' report on other financial information.

# Boston Children's Hospital and Subsidiaries

## Consolidating Statement of Operations

Year Ended September 30, 2016

(In Thousands)

	Children's Hospital	Children's Medical Center	Obligated to the Payment of the Bonds	Physician Organization at Children's Hospital, Inc. and Foundations	Other Subsidiaries	Eliminations	Children's Medical Center Consolidated
Revenues:							
Patient services revenue, net of contractual allowances and discounts	\$ 1,179,426	\$ –	\$ 1,179,426	\$ 593,138	\$ 121,966	\$ (8,105)	\$ 1,886,425
Provision for uncollectible accounts	(41,234)	–	(41,234)	(24,030)	–	–	(65,264)
Net patient services revenue	1,138,192	–	1,138,192	569,108	121,966	(8,105)	1,821,161
Research grants and contracts	195,721	–	195,721	–	–	(10,015)	185,706
Recovery of indirect costs on grants and contracts	74,213	–	74,213	–	–	(2,891)	71,322
Other operating revenue	49,831	4,906	54,737	–	36,586	19,506	110,829
Unrestricted contributions, net of fundraising expenses	12,805	–	12,805	–	–	(81)	12,724
Research revenue	–	–	–	41,387	–	(41,387)	–
Clinical and other revenue	–	–	–	44,888	–	(44,888)	–
Teaching, administration and supervision revenue	–	–	–	10,764	–	(10,764)	–
Net assets released from restriction used for operations	75,362	–	75,362	8,583	–	(18,458)	65,487
Total revenues	1,546,124	4,906	1,551,030	674,730	158,552	(117,083)	2,267,229
Expenses:							
Salaries and benefits	687,756	6	687,762	545,601	108,366	4,160	1,345,889
Supplies and other expenses	464,245	411	464,656	41,274	64,480	(33,100)	537,310
Direct research expenses of grants	195,721	–	195,721	–	–	(10,015)	185,706
Health Safety Net assessment	10,101	–	10,101	–	–	–	10,101
Medical service expenses	–	–	–	35,166	–	(35,166)	–
Research expenses	–	–	–	17,116	–	(17,116)	–
Contributions	–	–	–	26,452	–	(26,452)	–
Depreciation and amortization	114,516	559	115,075	2,261	8,099	–	125,435
Interest and net interest rate swap cash flows	33,975	–	33,975	–	225	–	34,200
Total expenses	1,506,314	976	1,507,290	667,870	181,170	(117,689)	2,238,641
Gain (loss) from operations	39,810	3,930	43,740	6,860	(22,618)	606	28,588
Non-operating gains (losses):							
Income (loss) from investments	7,379	6,217	13,596	12,777	(749)	11,449	37,073
Net realized gains (losses) on investments	1,444	30,913	32,357	15,283	(35)	–	47,605
Unrealized gain on investments classified as trading securities, net	–	–	–	10,011	–	–	10,011
Increase in value of alternative investments, net	2,952	62,479	65,431	16,981	–	15,547	97,959
Recognition of unrealized losses on other than trading investments	(786)	(23,553)	(24,339)	–	–	(2,849)	(27,188)
Fundraising expenses on restricted contributions	(20,349)	–	(20,349)	–	–	–	(20,349)
Adjustment of interest rate swaps to fair value	(30,780)	–	(30,780)	–	–	–	(30,780)
Other non-operating (losses) gains	–	(8,200)	(8,200)	4,069	(413)	69	(4,475)
Total non-operating (losses) gains	(40,140)	67,856	27,716	59,121	(1,197)	24,216	109,856
(Deficiency) excess of revenues over expenses	\$ (330)	\$ 71,786	\$ 71,456	\$ 65,981	\$ (23,815)	\$ 24,822	\$ 138,444

See accompanying independent auditors' report on other financial information.

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