

AUDITED CONSOLIDATED FINANCIAL STATEMENTS
AND SUPPLEMENTARY INFORMATION

Boston Children's Hospital and Subsidiaries
Years Ended September 30, 2016 and 2015
With Reports of Independent Auditors

Ernst & Young LLP



Boston Children’s Hospital and Subsidiaries

Audited Consolidated Financial Statements
and Supplementary Information

Years Ended September 30, 2016 and 2015

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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 and Subsidiaries (d/b/a Boston Children's Hospital and Subsidiaries), which comprise the consolidated balance sheets as of September 30, 2016 and 2015, 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 \$1,171 million and \$1,085 million and total revenues of \$675 million and \$638 million as of and for the years ended September 30, 2016 and 2015, 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 and Subsidiaries at September 30, 2016 and 2015, 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 13, 2017

Boston Children's Hospital and Subsidiaries

Consolidated Balance Sheets (In Thousands)

	September 30	
	2016	2015
Assets		
Current assets:		
Cash and cash equivalents	\$ 154,236	\$ 140,603
Patient accounts receivable, net of allowance for uncollectible accounts of \$50,747 and \$40,170 in 2016 and 2015, respectively	270,107	264,567
Other receivables	50,305	41,234
Grants receivable	39,311	41,279
Current portion of pledges receivable, net	40,130	33,916
Other current assets	42,223	31,650
Total current assets	596,312	553,249
Investments:		
Unrestricted as to use	1,838,046	1,626,012
Limited by Board designation	2,228,760	2,217,850
Restricted by donor-imposed restriction	572,351	544,094
	4,639,157	4,387,956
Other assets whose use is limited:		
By externally administered trusts	47,881	47,276
For deferred compensation and other benefit obligations	150,815	145,387
By long-term debt agreements	2,517	36,837
Other	3,735	4,421
	204,948	233,921
Property, plant, and equipment, net	1,174,051	1,075,738
Goodwill and other intangible assets	41,776	20,682
Pledges receivable, net	88,169	79,647
Other assets	69,027	61,151
Total assets	\$ 6,813,440	\$ 6,412,344

Boston Children's Hospital and Subsidiaries

Consolidated Balance Sheets (continued)
(In Thousands)

	September 30	
	2016	2015
Liabilities and net assets		
Current liabilities:		
Accounts payable and accrued expenses	\$ 173,965	\$ 181,587
Accrued salaries and wages	117,204	100,488
Current portion of estimated third-party settlement liabilities	3,248	2,731
Current portion of long-term debt	1,100	271
Current portion of notes payable	814	1,470
Deferred revenue	55,737	46,663
Other current liabilities	1,376	603
Total current liabilities	<u>353,444</u>	<u>333,813</u>
Long-term liabilities:		
Long-term debt	868,717	862,342
Mortgage notes payable	64,421	64,531
Estimated third-party settlement liabilities	10,350	9,631
Net pension liability	171,783	93,213
Funds held for others	45,889	44,838
Interest rate swap liability	177,094	146,314
Deferred compensation and other benefit obligations	132,743	127,770
Other liabilities	138,365	104,532
Total long-term liabilities	<u>1,609,362</u>	<u>1,453,171</u>
Net assets:		
Unrestricted	4,102,103	3,918,267
Temporarily restricted	507,194	486,112
Permanently restricted	241,337	220,981
Total net assets	<u>4,850,634</u>	<u>4,625,360</u>
Total liabilities and net assets	<u>\$ 6,813,440</u>	<u>\$ 6,412,344</u>

See accompanying notes.

Boston Children's Hospital and Subsidiaries

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

	Year Ended September 30	
	2016	2015
Revenues:		
Patient services revenue, net of contractual allowances and discounts	\$ 1,886,425	\$ 1,663,435
Provision for uncollectible accounts	(65,264)	(44,535)
Net patient services revenue	1,821,161	1,618,900
Research grants and contracts	185,706	177,310
Recovery of indirect costs on grants and contracts	71,322	63,166
Other operating revenue	110,829	87,252
Unrestricted contributions, net of fundraising expenses of \$8,721 and \$7,947 in 2016 and 2015, respectively	12,724	8,939
Net assets released from restrictions used for operations	65,487	46,740
Total revenues	2,267,229	2,002,307
Expenses:		
Salaries and benefits	1,345,889	1,133,483
Supplies and other expenses	537,310	467,232
Direct research expenses of grants	185,706	177,310
Health Safety Net assessment	10,101	8,570
Depreciation and amortization	125,435	114,046
Interest and net interest rate swap cash flows	34,200	34,234
Total expenses	2,238,641	1,934,875
Gain from operations	28,588	67,432
Non-operating gains (losses):		
Income from investments	37,073	58,204
Net realized gain on investments	47,605	90,246
Unrealized gain (loss) on investments classified as trading securities	10,011	(26,408)
Increase (decrease) in value of alternative investments	97,959	(1,890)
Recognition of unrealized losses on other than trading investments	(27,188)	(96,227)
Fundraising expenses on restricted contributions	(20,349)	(18,542)
Adjustment of interest rate swaps to fair value	(30,780)	(33,579)
Other non-operating losses	(4,475)	(7,788)
Total non-operating gains (losses)	109,856	(35,984)
Excess of revenues over expenses	138,444	31,448

Boston Children's Hospital and Subsidiaries

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

	Year Ended September 30	
	2016	2015
Changes in unrestricted net assets:		
Excess of revenues over expenses	\$ 138,444	\$ 31,448
Net assets released from restrictions for capital asset acquisitions	947	3,239
Net unrealized gain (loss) on other than trading investments	122,866	(113,679)
Net asset transfer	(402)	(1,079)
Depreciation on endowment funds	(1,035)	(3,200)
Pension adjustment	(76,984)	(84,835)
Increase (decrease) in unrestricted net assets	183,836	(168,106)
Changes in temporarily restricted net assets:		
Contributions	63,165	52,933
Income and net realized gain on investments	6,077	16,694
Recognition of unrealized losses on investments	(5,535)	(16,928)
Increase in value of alternative investments	16,486	1,478
Net unrealized gain (loss) on investments	6,353	(9,945)
Net asset transfer	(65)	166
Appreciation on endowment funds	1,035	3,200
Net assets released from restrictions	(66,434)	(49,979)
Increase (decrease) in temporarily restricted net assets	21,082	(2,381)
Changes in permanently restricted net assets:		
Contributions	19,889	11,194
Net asset transfer	467	913
Increase in permanently restricted net assets	20,356	12,107
Increase (decrease) in net assets	225,274	(158,380)
Net assets at beginning of year	4,625,360	4,783,740
Net assets at end of year	\$ 4,850,634	\$ 4,625,360

See accompanying notes.

Boston Children's Hospital and Subsidiaries

Consolidated Statements of Cash Flows (In Thousands)

	Year Ended September 30	
	2016	2015
Operating activities		
Change in net assets	\$ 225,274	\$ (158,380)
Non-cash and non-operating activities included in change in net assets:		
Depreciation and amortization	125,435	114,046
Restricted contributions	(83,054)	(64,127)
Net realized and unrealized (gain) loss on investments	(294,300)	98,455
Net unrealized (gains) losses on investments classified as trading securities	(10,011)	26,408
Changes in operating assets and liabilities:		
Investments classified as trading securities	7,396	34,333
Patient accounts receivable	(5,540)	(33,024)
Other accounts receivable	(7,103)	(3,782)
Other assets	(19,550)	(10,855)
Accounts payable and accrued expenses	9,368	36,669
Estimated third-party liabilities	1,236	(9,675)
Other liabilities	137,051	138,870
Net cash provided by operating activities	86,202	168,938
Financing activities		
Payments of note payable	(766)	(719)
Capital lease payments	(271)	(265)
(Decrease) increase in pledges receivable	(14,736)	12,696
Restricted contributions	83,054	64,127
Net cash provided by financing activities	67,281	75,839
Investing activities		
Cash paid for acquisition, net of cash acquired	-	(21,491)
Purchases of investments	(746,637)	(1,033,581)
Proceeds from sales of investments	792,351	963,832
Additions to fixed assets, net of retirements	(212,020)	(156,515)
Decrease (increase) in other assets whose use is limited	26,456	(2,237)
Net cash used in investing activities	(139,850)	(249,992)
Net increase (decrease) in cash and cash equivalents	13,633	(5,215)
Cash and cash equivalents at beginning of year	140,603	145,818
Cash and cash equivalents at end of year	\$ 154,236	\$ 140,603

See accompanying notes.

Boston Children's Hospital and Subsidiaries

Notes to Consolidated Financial Statements

September 30, 2016

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 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) Fenmore Realty Corporation, which owns and operates real property and distributes the net income of such property to the Medical Center; (g) Longwood Corporation, which owns and operates real property and distributes the net income of such property to the Medical Center; (h) Boston Children's Health Physicians; and (i) 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, 2016, which in no case is more than three months prior to September 30, 2016. 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.

Acquisition

Effective July 1, 2015, the Medical Center acquired a controlling interest in Boston Children's Health Physicians (BCHP), formerly known as Children's & Women's Physicians of Westchester, LLP, a fully integrated health care community that provides pediatric physician

Boston Children's Hospital and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

inpatient and outpatient care to patients throughout the New York Metropolitan Area, the Hudson Valley, Connecticut, and New Jersey. The Medical Center provided approximately \$29,659,000 in total consideration, including \$21,713,000 of cash consideration, to complete the BCHP acquisition.

The BCHP acquisition has been accounted for using the acquisition method of accounting in accordance with Accounting Standards Codification (ASC) Topic 958-805, *Business Combinations – Not-for-Profit Entities*. The purchase consideration has been allocated to the assets and liabilities acquired based on estimated fair values, and any excess of the purchase price over the fair value of such identifiable net assets has been allocated to goodwill. Determining the fair value of the assets acquired and liabilities assumed requires judgment and involves the use of significant estimates and assumptions, including assumptions with respect to future cash inflows and outflows and discount rates, among others. The fair values of assets acquired and liabilities assumed at the date of the BCHP acquisition were as follows (amounts in thousands):

Cash	\$	222
Patient accounts receivable		12,634
Other current assets		948
Property and equipment		6,669
Other long-term assets		289
Goodwill and identifiable intangible assets		20,682
Total assets acquired		<u>41,444</u>
Accounts payable and accrued expenses		10,184
Accrued salaries and wages		1,601
Total liabilities assumed		<u>11,785</u>
Net assets acquired	\$	<u>29,659</u>

The Medical Center recognized goodwill of approximately \$18,582,000 in connection with the BCHP acquisition. The Medical Center believes the factors contributing to the goodwill that resulted from the BCHP acquisition include, but are not limited to, the access to long-term patient, employee, and physician relationships.

Boston Children's Hospital and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

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.

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 and for the year ending September 30, 2016. BRI's financial position and results of operations are not material to the Medical Center's consolidated financial statements.

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, 2016.

Boston Children's Hospital and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

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 unrepresented, checks totaling \$28,105,000 and \$21,158,000 at September 30, 2016 and 2015, 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).

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 assets are recorded as an increase or decrease in unrestricted net assets. Net realized and unrealized gains or losses on restricted assets 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.

Boston Children's Hospital and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

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 \$212,042,000 and \$158,528,000 at September 30, 2016 and 2015, 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 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.

Boston Children's Hospital and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

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. The Medical Center's policy is to fund depreciation expense in amounts not exceeding cumulative allowable depreciation expense. Amortization expense related to assets recorded under capital leases is included with depreciation expense.

Goodwill and Other Intangible Assets

Goodwill recorded in connection with the acquisition of BCHP 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, 2016. No impairment losses were recognized during 2016.

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 \$1,725,000 as of September 30, 2016. 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 \$21,469,000 as of September 30, 2016.

Boston Children's Hospital and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

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 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.

Boston Children's Hospital and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

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. 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).

The Medical Center and its subsidiaries also record a provision for uncollectible accounts related primarily to uninsured accounts 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.

Boston Children's Hospital and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

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, 2016 and 2015, totaled \$1,330,000 and \$4,837,000, 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.

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.

Boston Children's Hospital and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

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.

Income Taxes

The Medical Center; the Hospital; the Foundations; the P.O.; CHB Properties, Inc.; BRI; and Longwood Research Institute, Inc. 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 and Fenmore Realty Corporation are Section 501(c)(2) organizations exempt from income taxes on related business income pursuant to Code Section 501(a). BCHP is a limited liability partnership disregarded for tax purposes.

Boston Children's Hospital and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

New Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 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 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. Early application is permitted for the fiscal year ending September 30, 2018. The Medical Center is in the process of evaluating the impact of ASU 2014-09 on its consolidated financial statements and has not yet determined if it will early adopt the provisions of ASU 2014-09.

In April 2015, the FASB issued ASU No. 2015-03, *Interest – Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs*, which requires that debt issuance costs be presented on the balance sheet as a deduction from the carrying amount of the related liability, rather than as a deferred charge. The updated guidance is effective retroactively for financial statements covering fiscal years beginning October 1, 2016, and interim periods within those fiscal years. Early application is permitted. The Medical Center adopted ASU 2015-03 for the year ending September 30, 2016, and, accordingly, has classified debt issuance costs of \$6,009,000 and \$6,224,000 as of September 30, 2016 and 2015, respectively as a reduction to the carrying amount of debt.

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 in the process of evaluating the impact of ASU 2016-02 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 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 not-for-profit (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.

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 standard is effective for the fiscal year ending September 30, 2017. The Medical Center does not currently expect the adoption of this standard will have a material effect on its consolidated financial statements.

In April 2015, the FASB issued ASU 2015-05, *Intangibles – Goodwill and Other – Internal-Use Software (Subtopic 350-40): Customer's Accounting for Fees Paid in a Cloud Computing Arrangement*. This ASU is intended to assist in the evaluation of the accounting for fees paid by a customer in a cloud computing arrangement by providing guidance as to whether an arrangement includes the sale or license of software. The guidance is effective for annual periods beginning after December 15, 2015. Early adoption is permitted for all entities and the Medical Center early adopted this ASU on October 1, 2015. 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)

2. Investments and Other Assets Whose Use Is Limited

Investments and other assets whose use is limited consist of the following, at fair value:

	September 30	
	2016	2015
	<i>(In Thousands)</i>	
Pooled investments:		
Cash and cash equivalents	\$ 19,712	\$ 49,434
Equity securities	1,213,560	1,045,132
Fixed income securities	464,348	461,918
Alternative investments	1,602,762	1,504,102
Total pooled investments	3,300,382	3,060,586
Non-pooled investments:		
Cash equivalents	239,855	258,656
Mutual funds	192,186	174,629
Equity securities	359,832	331,031
Fixed income securities	404,491	406,880
Real estate	234,543	241,298
Other	53,802	54,888
Total non-pooled investments	1,484,709	1,467,382
Long-term debt agreements (money market funds)	2,517	36,837
Externally administered trusts (marketable debt and equity securities)	47,881	47,276
Other	8,616	9,796
Total investments and other assets whose use is limited	\$ 4,844,105	\$ 4,621,877

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.

Boston Children's Hospital and Subsidiaries

Notes to Consolidated Financial Statements (continued)

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

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

	September 30	
	2016	2015
	<i>(In Thousands)</i>	
Investments, unrestricted as to use	\$ 1,838,046	\$ 1,626,012
Investments and other assets whose use is limited:		
By Board designation for plant replacement and expansion and mission-related activities	2,228,760	2,217,850
By donor-imposed restriction	572,351	544,094
By long-term debt agreements	2,517	36,837
For deferred compensation and other benefit obligations	150,815	145,387
By externally administered trusts	47,881	47,276
Other:		
As funds held for others	1,162	1,015
Other	2,573	3,406
	3,735	4,421
Total investments and other assets whose use is limited	\$ 4,844,105	\$ 4,621,877

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>		
Year ended September 30, 2016			
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	<u>\$ 293,551</u>	<u>\$ 23,381</u>	<u>\$ 316,932</u>

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

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>		
Year ended September 30, 2015			
Interest and dividend income:			
Operating revenue	\$ 1,688	\$ –	\$ 1,688
Non-operating revenue	58,204	–	58,204
Increase in temporarily restricted net assets	–	3,510	3,510
(Decrease) increase in value of alternative investments	(1,890)	1,478	(412)
Net realized gain	90,246	13,184	103,430
Recognition of unrealized losses	(96,227)	(16,928)	(113,155)
Net unrealized losses on other than trading securities	(113,679)	(9,945)	(123,624)
Net unrealized losses on trading securities	(26,408)	–	(26,408)
Total net loss on investments	\$ (88,066)	\$ (8,701)	\$ (96,767)

Investment income is reported net of fees of \$9,154,000 for the year ended September 30, 2015.

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 \$32,723,000 and \$113,155,000 for the years ended September 30, 2016 and 2015, respectively, of which \$27,188,000 and \$96,227,000 is included in unrestricted investment income, and \$5,535,000 and \$16,928,000 is included in changes in temporarily restricted net assets. There were no investments that had aggregate gross unrealized losses at September 30, 2016 or 2015.

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:

	Year Ended September 30	
	2016	2015
	<i>(In Thousands)</i>	
Gross contributions	\$ 107,821	\$ 81,382
Provision for uncollectible pledges	(2,392)	(59)
Amortization of discount	(930)	(310)
Net contributions	<u>\$ 104,499</u>	<u>\$ 81,013</u>

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

	Year Ended September 30	
	2016	2015
	<i>(In Thousands)</i>	
Unrestricted contributions	\$ 21,445	\$ 16,886
Temporarily restricted	63,165	52,933
Permanently restricted	19,889	11,194
Net contributions	<u>\$ 104,499</u>	<u>\$ 81,013</u>

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. In addition to the \$81,382,000 in gross contributions raised for the year ended September 30, 2015, the Medical Center raised \$16,579,000 in non-governmental grant awards, to bring the total funds raised to \$97,961,000.

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:

	September 30	
	2016	2015
	<i>(In Thousands)</i>	
Due in less than one year	\$ 40,130	\$ 36,202
Due in one to five years	84,279	72,151
Due in more than five years	22,148	22,100
	146,557	130,453
Less discount to present value	(10,677)	(9,615)
Less allowance for uncollectible pledges	(7,581)	(7,275)
	128,299	113,563
Less current portion of pledges receivable, net	(40,130)	(33,916)
Non-current portion of pledges receivable, net	\$ 88,169	\$ 79,647

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 its 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:

	Year Ended September 30	
	2016	2015
	<i>(In Thousands)</i>	
HST assessment	\$ 10,101	\$ 8,570
HST receipts (net patient service revenue)	(3,850)	(3,850)
Net disbursements to HST	6,251	4,720
Provision for uncollectible accounts	65,264	44,535
Free care (at cost)	7,301	8,430
Total HST, provision, and free care	\$ 78,816	\$ 57,685

5. Property, Plant, and Equipment

Property, plant, and equipment consist of the following:

	September 30	
	2016	2015
	<i>(In Thousands)</i>	
Land and improvements	\$ 17,139	\$ 17,124
Buildings, leasehold, and related improvements	1,816,911	1,710,660
Equipment	810,183	750,774
Construction-in-progress	128,663	65,061
	2,772,896	2,543,619
Less accumulated depreciation and amortization	(1,598,845)	(1,467,881)
	\$ 1,174,051	\$ 1,075,738

At September 30, 2016 and 2015, the Medical Center had commitments of approximately \$115,675,000 and \$76,077,000, respectively, to complete projects relating to capital construction and software development.

Boston Children's Hospital and Subsidiaries

Notes to Consolidated Financial Statements (continued)

6. Asset Retirement Obligations

Conditional asset retirement obligations amounted to \$13,018,000 and \$13,598,000 as of September 30, 2016 and 2015, 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 2016 and 2015, retirement obligations incurred and settled amounted to \$621,000 and \$1,592,000, respectively. Accretion expenses of \$41,000 and \$132,000 were recorded during the years ended September 30, 2016 and 2015, respectively.

7. Other Assets and Other Liabilities

Other assets consist of the following:

	September 30	
	2016	2015
	<i>(In Thousands)</i>	
Expected insurance recoveries for professional liability claims <i>(Note 14)</i>	\$ 52,864	\$ 46,114
Employee loans receivable	11,855	12,048
Other	4,308	2,989
	\$ 69,027	\$ 61,151

Other liabilities consist of the following:

	September 30	
	2016	2015
	<i>(In Thousands)</i>	
Estimated insured professional liability losses <i>(Note 14)</i>	\$ 52,864	\$ 46,114
Software license obligation	22,545	–
Accrued lease escalations	17,858	14,350
Non-current portion of liability for claims incurred but not reported	13,216	14,674
Asset retirement obligation reserve <i>(Note 6)</i>	13,018	13,598
Promissory notes	11,475	12,425
Non-current portion of lease incentive obligation	7,389	3,371
	\$ 138,365	\$ 104,532

Boston Children's Hospital and Subsidiaries

Notes to Consolidated Financial Statements (continued)

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, 2016, are as follows (in thousands):

2017	\$	42,723
2018		42,623
2019		43,340
2020		43,552
2021		43,776
Thereafter		76,885
Total operating leases	\$	<u>292,899</u>

Rent expense was approximately \$64,514,000 and \$47,476,000 for the years ended September 30, 2016 and 2015, respectively.

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, 2016 and 2015, the accumulated difference between rent expense and amounts paid amounted to \$17,858,000 and \$14,349,000, respectively, which is included in other liabilities on the accompanying consolidated balance sheets.

Boston Children's Hospital and Subsidiaries

Notes to Consolidated Financial Statements (continued)

9. Long-Term Debt and Mortgage Notes

Long-term debt consists of the following:

	September 30	
	2016	2015
	<i>(In Thousands)</i>	
Series M	\$ 124,785	\$ 124,719
Series N	216,590	216,590
Series O	200,640	200,640
Series P	150,467	151,012
Series Q	50,255	50,255
Series R	125,350	125,350
Series A (BRI)	7,739	–
Capital leases	–	271
	875,826	868,837
Less:		
Unamortized debt issuance costs	6,009	6,224
Current portion of long-term debt	1,100	271
	\$ 868,717	\$ 862,342

Interest paid was \$17,392,000 and \$17,133,000 for the years ended September 30, 2016 and 2015, respectively. Interest capitalized in connection with ongoing construction projects approximated \$903,000 and \$262,000 in 2016 and 2015, respectively.

Series M Bonds

On November 18, 2009, the Hospital issued Series M 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.

Boston Children's Hospital and Subsidiaries

Notes to Consolidated Financial Statements (continued)

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

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 and are secured by bank letters of credit. These bank letters of credit will expire on December 2, 2017 and November 30, 2018. Interest payments are due monthly. Interest on the bonds is variable based on weekly (Series N-3) and daily (Series N-4) auctions and was .82%, and .83% for Series N-3 and N-4, respectively, on September 30, 2016. 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 1.02% and .98%, respectively, on September 30, 2016. Interest payments are due monthly. Principal on the loans is due at maturity in 2023 and in 2028.

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. The first annual principal payment is due in 2031.

Boston Children's Hospital and Subsidiaries

Notes to Consolidated Financial Statements (continued)

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

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 .87% on September 30, 2016. 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 .95% on September 30, 2016. 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 Massachusetts Health and Education Facilities Authorities (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.

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.

Boston Children's Hospital and Subsidiaries

Notes to Consolidated Financial Statements (continued)

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

Capital Lease

During 2011, the Hospital obtained MHEFA financing of \$1,300,000 for equipment to be purchased under capital leases. Principal and interest were paid semiannually through 2016 at an annual interest rate of 2.15%. The capital lease matured in May 2016.

Mortgage Notes

On August 1, 2008, Fenmore Realty Corporation 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. The bank loan bears interest at a variable rate of .98% at September 30, 2016, and is scheduled to mature on November 30, 2019. Interest payments are due monthly.

As of September 30, 2016, 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, 2016, are as follows:

	Series A Bonds	Series M Bonds	Series N Bonds	Series O Bonds	Series P Bonds	Series Q Bonds	Series R Bonds	Mortgage Notes	Total
Years ending									
September 30:									
2017	\$ 1,100	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 814	\$ 1,914
2018	1,200	-	-	-	-	-	-	37,421	38,621
2019	1,300	-	-	-	-	-	-	-	1,300
2020	1,400	-	-	-	-	-	-	27,000	28,400
2021	1,500	-	-	-	-	-	-	-	1,500
Thereafter	1,500	126,110	216,590	200,640	136,685	50,255	125,350	-	857,130
Principal payments	8,000	126,110	216,590	200,640	136,685	50,255	125,350	65,235	928,865
Premium (discount)	(261)	(1,325)	-	-	13,782	-	-	-	12,196
Total	\$ 7,739	\$ 124,785	\$ 216,590	\$ 200,640	\$ 150,467	\$ 50,255	\$ 125,350	\$ 65,235	\$ 941,061
Less:									
Unamortized debt issuance costs									(6,009)
									<u>\$ 935,052</u>

Interest Rate Swap Agreements

The Medical Center was a party to the following interest rate swap agreements as of September 30, 2016:

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 4.0% through October 1, 2028, if the variable rate tax-exempt index reaches 4.5%.

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 \$177,094,000 and \$146,314,000 at September 30, 2016 and 2015, respectively) is reported in long-term liabilities on the accompanying consolidated balance sheets, and the change in fair value of \$(30,780,000) and \$(33,579,000) for the years ended September 30, 2016 and 2015, respectively, is reported as a non-operating 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 \$17,069,000 and \$17,897,000 in 2016 and 2015, 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, 2016 and 2015 is a liability of approximately \$37,033,000 and \$32,760,000, respectively.

Guaranteed Debt

As security to the Hospital's direct purchase loan agreements with banks and Series M, N, and P bondholders, 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.

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:

	September 30	
	2016	2015
	<i>(In Thousands)</i>	
Mission-related activities	\$ 286,918	\$ 252,469
Accumulated gains on permanently restricted net assets	220,276	233,643
	\$ 507,194	\$ 486,112

Permanently restricted net assets are restricted as follows:

	September 30	
	2016	2015
	<i>(In Thousands)</i>	
Investments to be held in perpetuity, the income from which is:		
Unrestricted as to use	\$ 31,939	\$ 28,251
Restricted for patient care-related activities	118,897	139,609
Restricted for research	68,848	34,586
Restricted for medical education	21,653	18,535
	\$ 241,337	\$ 220,981

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:

	Board- Designated Funds	Temporarily Restricted Funds	Permanently Restricted Funds	Total Endowment Funds
	<i>(In Thousands)</i>			
Year ended September 30, 2016				
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	\$ 865,326	\$ 220,345	\$ 195,216	\$ 1,280,887

*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.

Boston Children's Hospital and Subsidiaries

Notes to Consolidated Financial Statements (continued)

10. Restricted Net Assets (continued)

	Board- Designated Funds	Temporarily Restricted Funds	Permanently Restricted Funds	Total Endowment Funds
<i>(In Thousands)</i>				
Year ended September 30, 2015				
Endowment net assets at beginning of year	\$ 881,013	\$ 261,365	\$ 169,242	\$ 1,311,620
Investment return:				
Investment income	5,167	2,462	–	7,629
Net depreciation	(25,178)	(12,330)	–	(37,508)
Total investment loss	(20,011)	(9,868)	–	(29,879)
Contributions	15,714	–	10,274	25,988
Net asset reclassifications	755	–	–	755
Amounts appropriated for expenditure	(39,788)	(16,679)	–	(56,467)
Endowment net assets at end of year	<u>\$ 837,683</u>	<u>\$ 234,818</u>	<u>\$ 179,516</u>	<u>\$ 1,252,017</u>

*Excluded from the above table, but included in total permanently restricted net assets for the year ended September 30, 2015, are permanently restricted pledges of \$7,954 and externally administered trusts of \$33,511.

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 7% 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% 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 \$1,033,864 as of September 30, 2016. The deficiency reported as of September 30, 2015, was \$3,200,000. These deficiencies 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:

	Year Ended September 30	
	2016	2015
	<i>(In Thousands)</i>	
Mission-related activities	\$ 65,487	\$ 46,740
Property, plant, and equipment	947	3,239
	\$ 66,434	\$ 49,979

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 16.4%, respectively, of the Medical Center's net patient services revenue for 2016. Revenues from Medicare and Medicaid, including Medicaid out-of-state programs, accounted for approximately 1.0% and 19.1%, respectively, of the Medical Center's net patient services revenue for 2015.

During 2016 and 2015, in connection with special legislative appropriations, the Medical Center received \$20,411,000 and \$17,387,000, 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 \$9,344,000 and \$15,302,000 in 2016 and 2015, 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 allowances for uncollectible accounts increased from 13% of accounts receivable at September 30, 2015, to 16% of accounts receivable at September 30, 2016, due to deterioration in the accounts receivable aging. The Hospital's and Foundations' self-pay and third-party payor write-offs were \$78,306,000 and \$57,235,000 for fiscal years 2016 and 2015, respectively. Write-offs as a percentage of net patient service revenue were 4% and 4% for fiscal years 2016 and 2015, respectively. The Hospital and Foundations have not changed their charity care or uninsured discount policies during fiscal year 2016. 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:

	Year Ended September 30	
	2016	2015
Commercial/other managed care	31.9%	29.6%
Blue Cross	20.9	21.6
Medicaid	17.0	15.9
International	22.5	25.3
Patients	5.1	5.3
Other governmental	2.6	2.3
Total	100.0%	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:

	Amount	Percentage
	<i>(In Thousands)</i>	
Year ended September 30, 2016		
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%
Year ended September 30, 2015		
Commercial/other managed care	\$ 609,520	36.7%
Blue Cross	529,214	31.8
Medicaid	307,838	18.5
International	118,519	7.1
Patients	37,032	2.2
Other governmental	43,925	2.6
Other	17,387	1.1
Revenues before provision for uncollectible accounts	1,663,435	100.0
Provision for uncollectible accounts	(44,535)	(2.8)
Net patient services revenue	\$ 1,618,900	97.2%

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:

	Year Ended September 30	
	2016	2015
	<i>(In Thousands)</i>	
Change in benefit obligation		
Benefit obligation at beginning of year	\$ 809,003	\$ 744,648
Service cost	46,462	45,267
Interest cost	34,344	30,961
Actuarial loss	78,436	7,546
Plan amendments	1,300	-
Plan established	2,689	-
Settlements	(8,406)	-
Benefits paid	(19,994)	(19,419)
Benefit obligations at end of year	<u>943,834</u>	809,003
Change in plan assets		
Fair value of plan assets at beginning of year	715,790	732,149
Actual return on plan assets	43,968	(27,277)
Employer contributions	40,346	30,337
Settlements	(8,059)	-
Benefits paid	(19,994)	(19,419)
Fair value of plan assets at end of year	<u>772,051</u>	715,790
Funded status		
Net pension liability at end of year	<u>\$ (171,783)</u>	<u>\$ (93,213)</u>
Accumulated benefit obligation	<u>\$ 832,556</u>	<u>\$ 725,248</u>

Boston Children's Hospital and Subsidiaries

Notes to Consolidated Financial Statements (continued)

12. Employees' Retirement Plans (continued)

	As of September 30	
	2016	2015
Amounts not yet recognized in net periodic benefit cost and included in unrestricted net assets		
Actuarial net loss	\$ 221,765	\$ 146,403
Transition obligation cost	—	—
Prior service credit	(10,509)	(12,130)
	<u>\$ 211,256</u>	<u>\$ 134,273</u>

The aggregate projected benefit obligation and fair value of plan assets for defined benefit plans with benefit obligations in excess of plan assets was \$927,082,000 and \$751,808,000 as of September 30, 2016, and \$789,270,000 and \$689,096,000 as of September 30, 2015. 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 \$16,752,000 and \$20,242,000 as of September 30, 2016, and \$19,733,000 and \$26,694,000 as of September 30, 2015.

	Year Ended September 30	
	2016	2015
	<i>(In Thousands)</i>	
Components of net periodic benefit cost		
Service cost	\$ 46,462	\$ 45,267
Interest cost	34,344	30,961
Expected return on plan assets	(49,409)	(50,854)
Effect of settlement	2,697	—
Plan established	2,689	—
Amortization of unrecognized net loss	5,472	473
Amortization of net transition obligation	—	612
Amortization of prior service credit	(321)	(399)
Net periodic benefit cost	<u>\$ 41,934</u>	<u>\$ 26,060</u>

Prior service credit of \$321,000 and unrecognized actuarial losses of \$10,208,000 are expected to be recognized in net periodic pension cost during the fiscal year ending September 30, 2017.

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:

	Year Ended September 30	
	2016	2015
Discount rates	4.35%–4.40%	4.20%–4.50%
Expected return on plan assets	7.00%	7.00%
Rates of compensation increase	2.00%–4.00%	2.00%–4.00%

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

	Year Ended September 30	
	2016	2015
Discount rates	3.60%–3.70%	4.35%–4.40%
Rates of compensation increase	2.00%–4.00%	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:

	September 30	
	2016	2015
Cash and cash equivalents	4.1%	5.0%
U.S. equities	15.9	16.7
Mutual funds	7.1	2.4
Global equities	19.1	15.8
Fixed income	12.6	17.1
Alternative investments	41.2	43.0
Total	100.0%	100.0%

Contributions

The Hospital and Foundations expect to contribute an aggregate of approximately \$33,019,000 to their pension plans in 2017.

Estimated Future Benefit Payments

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

	Pension Benefits
2017	\$ 59,824
2018	48,034
2019	50,076
2020	57,641
2021	63,062
Years 2022–2027	354,483

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 \$4,133,000 and \$3,646,000 for the years ended September 30, 2016 and 2015, 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 \$5,559,000 and \$5,555,000 for the years ended September 30, 2016 and 2015, 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, 2016 and 2015, amounted to \$28,549,000 and \$27,222,000, 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:

	Assets	Liabilities	Expense
	<i>(In Thousands)</i>		
2016			
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
2015			
Supplemental retirement benefit plans	\$ 72,171	\$ 82,861	\$ 9,943
Other benefit plan obligations	73,216	44,909	7,503
	\$ 145,387	\$ 127,770	\$ 17,446

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, 2016, was \$13,272,000 and at September 30, 2015, was \$14,727,000. Additionally, the Hospital and Foundations recorded a liability of \$52,864,000 and \$46,114,000 at September 30, 2016 and 2015, respectively, related to estimated insured professional liability losses and a corresponding receivable of \$52,864,000 and \$46,114,000 at September 30, 2016 and 2015, 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	
	2016	2015
	<i>(In Thousands)</i>	
Professional liability insurance premiums, net of recoveries	\$ 13,791	\$ 10,984
Decrease in reserve for incurred but not reported professional liability claims	(1,455)	(245)
Total	<u>\$ 12,336</u>	<u>\$ 10,739</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.

Boston Children's Hospital and Subsidiaries

Notes to Consolidated Financial Statements (continued)

15. Fair Value of Financial Instruments (continued)

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.

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 \$1,891,107,000 and \$1,800,290,000 at September 30, 2016 and 2015, respectively.

Boston Children's Hospital and Subsidiaries

Notes to Consolidated Financial Statements (continued)

15. Fair Value of Financial Instruments (continued)

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

	September 30, 2016			
	Level 1	Level 2	Level 3	Total
	<i>(In Thousands)</i>			
Assets				
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
	\$ 1,347,342	\$ 1,472,228	\$ 133,428	\$ 2,952,998
Liabilities				
Interest rate swap agreements	\$ –	\$ 177,094	\$ –	\$ 177,094
	\$ –	\$ 177,094	\$ –	\$ 177,094
	September 30, 2015			
	Level 1	Level 2	Level 3	Total
	<i>(In Thousands)</i>			
Assets				
Cash and cash equivalents	\$ 315,742	\$ 150,277	\$ –	\$ 466,019
U.S. equities	686,900	82,338	–	769,238
Global equities	131,347	321,332	62,510	515,189
Investment-grade fixed income	68,724	619,094	–	687,818
Mutual funds	161,993	26,984	–	188,977
High-yield fixed income	–	53,825	–	53,825
Global bonds fixed income	–	45,472	–	45,472
Real asset funds	44,918	50,131	–	95,049
	\$ 1,409,624	\$ 1,349,453	\$ 62,510	\$ 2,821,587
Liabilities				
Interest rate swap agreements	\$ –	\$ 146,314	\$ –	\$ 146,314
	\$ –	\$ 146,314	\$ –	\$ 146,314

Boston Children's Hospital and Subsidiaries

Notes to Consolidated Financial Statements (continued)

15. Fair Value of Financial Instruments (continued)

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

	Year Ended September 30	
	2016	2015
<i>(In Thousands)</i>		
Balance, beginning of year	\$ 62,510	\$ 14,813
Net realized loss	(2,049)	(281)
Unrealized gains relating to investments still held at the reporting date	5,967	835
Purchases	67,000	48,000
Sales	-	(857)
Balance, end of year	<u>\$ 133,428</u>	<u>\$ 62,510</u>

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, 2016			
	Level 1	Level 2	Level 3	Total
<i>(In Thousands)</i>				
Assets				
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>

Boston Children's Hospital and Subsidiaries

Notes to Consolidated Financial Statements (continued)

15. Fair Value of Financial Instruments (continued)

	September 30, 2015			
	Level 1	Level 2	Level 3	Total
	<i>(In Thousands)</i>			
Assets				
Cash and cash equivalents	\$ 4,736	\$ 30,959	\$ –	\$ 35,695
U.S. equities	83,733	32,199	3,332	119,264
Mutual funds	8,934	7,854	539	17,327
Global equities	37,931	54,112	21,395	113,438
Investment-grade fixed income	46,491	50,331	–	96,822
High-yield fixed income	5,379	11,697	–	17,076
Global bonds fixed income	–	8,321	–	8,321
Real asset funds	7,796	14,512	644	22,952
Domestic equity hedge funds	–	–	107,014	107,014
Distressed debt hedge funds	–	–	59,793	59,793
Multistrategy hedge funds	–	–	39,011	39,011
Global equity hedge funds	–	–	58,761	58,761
Private equity partnerships	–	–	20,316	20,316
	<u>\$ 195,000</u>	<u>\$ 209,985</u>	<u>\$ 310,805</u>	<u>\$ 715,790</u>

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

	Year Ended September 30	
	2016	2015
	<i>(In Thousands)</i>	
Balance, beginning of year	\$ 310,805	\$ 293,968
Net realized gain (loss)	5,410	(5,790)
Unrealized gains relating to investments still held at the reporting date	6,370	39,898
Purchases	41,162	29,361
Sales	(29,347)	(46,632)
Balance, end of year	<u>\$ 334,400</u>	<u>\$ 310,805</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*
	2016	2015	
	Net Asset Value	Net Asset Value	
<i>(In Thousands)</i>			
U.S. equities	\$ 52,080	\$ 34,937	0 to 60 days
Global equities	101,278	72,165	30 to over 365 days
Cash and cash equivalents	26,803	30,960	0 to 30 days
Investment-grade fixed income	61,380	62,187	0 to 30 days
High-yield fixed income	12,236	10,100	0 to 30 days
Global bonds fixed income	10,327	8,118	0 to 30 days
Real asset funds	16,895	14,860	0 to 60 days
Domestic equity hedge funds	98,491	105,116	90 to over 365 days
Distressed debt hedge funds	62,104	59,018	90 to over 365 days
Multistrategy hedge funds	33,342	39,011	90 to over 365 days
Global equity hedge funds	14,393	20,315	90 to over 365 days
Private equity partnerships	80,647	58,761	Up to 7 years
	<u>\$ 569,976</u>	<u>\$ 515,548</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 2015.

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 following methods and assumptions were used in estimating the fair value of financial instruments:

Accounts payable and accrued expenses: The carrying amount reported on the consolidated balance sheets for accounts payable and accrued expenses approximates its fair value.

Estimated third-party payor settlements: The carrying amount reported on the consolidated balance sheets for estimated third-party payor settlements approximates its fair value.

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. 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 \$862,613,000 and \$66,001,000 respectively, at September 30, 2015. The fair value of the long-term obligations and mortgage notes was \$888,598,000 and \$68,507,000, respectively at September 30, 2015.

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:

	Year Ended September 30	
	2016	2015
	<i>(In Thousands)</i>	
Patient care	\$ 1,822,772	\$ 1,537,261
Research	371,984	354,027
Medical education	43,885	43,587
Total expenses	<u>\$ 2,238,641</u>	<u>\$ 1,934,875</u>

17. Subsequent Events

Subsequent events have been evaluated for potential recognition in the consolidated financial statements through January 13, 2017, which is the date the accompanying consolidated financial statements were issued. No subsequent events have occurred that require disclosure in or adjustment to the consolidated financial statements.

Supplementary Information

Report of Independent Auditors on Supplementary Information

The Board of Trustees
Boston Children's Hospital

We have audited the consolidated financial statements of Boston Children's Hospital and Subsidiaries as of and for the years ended September 30, 2016 and 2015, and have issued our report thereon dated January 13, 2017, which contained an unmodified opinion on those financial statements. Our audits were performed 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 \$1,171 million and \$1,085 million and total revenues of \$675 million and \$638 million as of and for the years ended September 30, 2016 and 2015, 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, 2016 and 2015, 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 of America. 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 13, 2017

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
Assets							
Current assets:							
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
Total current assets	2,473,101	(1,922,092)	551,009	238,776	(114,048)	(79,425)	596,312
Investments:							
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
Other assets whose use is limited:							
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
Total assets	\$ 4,797,671	\$ 685,133	\$ 5,482,804	\$ 1,170,778	\$ 285,728	\$ (125,870)	\$ 6,813,440

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
Liabilities and net assets							
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 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 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
Total current liabilities	315,287	2,643	317,930	100,594	22,583	(87,663)	353,444
Long-term liabilities:							
Long-term debt	862,158	–	862,158	–	6,559	–	868,717
Mortgage notes payable	–	–	–	–	64,421	–	64,421
Long-term portion of estimated third-party 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
Total long-term liabilities	1,323,685	17,961	1,341,646	201,740	84,352	(18,376)	1,609,362
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
Total net assets	3,158,699	664,529	3,823,228	868,444	178,793	(19,831)	4,850,634
Total liabilities and net assets	\$ 4,797,671	\$ 685,133	\$ 5,482,804	\$ 1,170,778	\$ 285,728	\$ (125,870)	\$ 6,813,440

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 from investments	7,379	6,217	13,596	12,777	(749)	11,449	37,073
Net realized gain on investments	1,444	30,913	32,357	15,283	(35)	-	47,605
Unrealized gain on investments classified as trading securities	-	-	-	10,011	-	-	10,011
Increase in value of alternative investments	2,952	62,479	65,431	16,981	-	15,547	97,959
Recognition of unrealized losses on investments	(786)	(23,553)	(24,339)	-	-	(2,849)	(27,188)
Gain on sale of real estate	-	-	-	-	-	-	-
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	-	(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.

Boston Children's Hospital and Subsidiaries

Consolidating Balance Sheet

September 30, 2015

(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
Assets							
Current assets:							
Cash and cash equivalents	\$ 506	\$ 31,435	\$ 31,941	\$ 107,597	\$ 1,910	\$ (845)	\$ 140,603
Patient accounts receivable, net of allowance for uncollectible accounts	183,476	–	183,476	68,637	12,454	–	264,567
Other receivables	47,768	17,400	65,168	10,855	101	(34,890)	41,234
Grants receivable	41,279	–	41,279	–	–	–	41,279
Due from Children's Hospital	–	–	–	18,580	–	(18,580)	–
Due from Parent	2,075,902	(2,002,149)	73,753	–	(73,753)	–	–
Current portion of pledges receivable, net	34,837	–	34,837	–	–	(921)	33,916
Other current assets	29,716	–	29,716	5,040	1,287	(4,393)	31,650
Total current assets	2,413,484	(1,953,314)	460,170	210,709	(58,001)	(59,629)	553,249
Investments:							
Unrestricted as to use	10,240	777,838	788,078	597,367	230,769	9,798	1,626,012
Limited by Board designation	79,197	1,541,143	1,620,340	63,388	–	534,122	2,217,850
Restricted by donor-imposed restriction	951,114	139,837	1,090,951	26,714	–	(573,571)	544,094
	1,040,551	2,458,818	3,499,369	687,469	230,769	(29,651)	4,387,956
Other assets whose use is limited:							
By externally administered trusts	47,276	–	47,276	–	–	–	47,276
For deferred compensation and other benefit obligations	3,236	–	3,236	142,151	–	–	145,387
By long-term debt agreements	36,837	–	36,837	–	–	–	36,837
Other	6,560	–	6,560	–	–	(2,139)	4,421
	93,909	–	93,909	142,151	–	(2,139)	233,921
Property, plant, and equipment, net	966,942	3,482	970,424	8,728	96,586	–	1,075,738
Goodwill and identifiable intangible assets	–	–	–	–	20,682	–	20,682
Pledges receivable, net	81,807	–	81,807	–	–	(2,160)	79,647
Other assets	24,790	–	24,790	36,047	314	–	61,151
Total assets	\$ 4,621,483	\$ 508,986	\$ 5,130,469	\$ 1,085,104	\$ 290,350	\$ (93,579)	\$ 6,412,344

Boston Children's Hospital and Subsidiaries

Consolidating Balance Sheet (continued)

September 30, 2015

(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
Liabilities and net assets							
Current liabilities:							
Accounts payable and accrued expenses	\$ 137,056	\$ 2,233	\$ 139,289	\$ 26,765	\$ 8,179	\$ 7,354	\$ 181,587
Accrued salaries and wages	73,325	463	73,788	18,534	8,395	(229)	100,488
Current portion of estimated third-party liabilities	5,993	—	5,993	—	—	(3,262)	2,731
Due to Children's Hospital	—	—	—	29,946	—	(29,946)	—
Promises to give	—	—	—	2,756	—	(2,756)	—
Current portion of long-term debt	271	—	271	—	—	—	271
Current portion of notes payable	—	—	—	—	1,470	—	1,470
Deferred revenue	83,162	—	83,162	2,684	—	(39,183)	46,663
Other current liabilities	603	—	603	—	—	—	603
Total current liabilities	300,410	2,696	303,106	80,685	18,044	(68,022)	333,813
Long-term liabilities:							
Long-term debt	862,342	—	862,342	—	—	—	862,342
Mortgage notes payable	—	—	—	—	64,531	—	64,531
Long-term portion of estimated third-party liabilities	9,631	—	9,631	—	—	—	9,631
Net pension liability	66,640	—	66,640	—	—	26,573	93,213
Funds held for others	38,858	8,726	47,584	—	—	(2,746)	44,838
Interest rate swap liability	146,314	—	146,314	—	—	—	146,314
Accrued defined benefit plan obligations, net	—	—	—	26,573	—	(26,573)	—
Deferred compensation and other benefit obligations	13,924	525	14,449	113,321	—	—	127,770
Promises to give	—	—	—	2,840	—	(2,840)	—
Other liabilities	64,861	7,946	72,807	31,557	168	—	104,532
Total long-term liabilities	1,202,570	17,197	1,219,767	174,291	64,699	(5,586)	1,453,171
Net assets:							
Unrestricted	1,852,300	489,093	2,341,393	802,910	207,607	566,357	3,918,267
Temporarily restricted	565,670	—	565,670	27,218	—	(106,776)	486,112
Permanently restricted	700,533	—	700,533	—	—	(479,552)	220,981
Total net assets	3,118,503	489,093	3,607,596	830,128	207,607	(19,971)	4,625,360
Total liabilities and net assets	\$ 4,621,483	\$ 508,986	\$ 5,130,469	\$ 1,085,104	\$ 290,350	\$ (93,579)	\$ 6,412,344

See accompanying independent auditors' report on other financial information.

Boston Children's Hospital and Subsidiaries

Consolidating Statement of Operations

Year Ended September 30, 2015

(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	\$ 1,088,733	\$ –	\$ 1,088,733	\$ 552,743	\$ 29,244	\$ (7,285)	\$ 1,663,435
Provision for uncollectible accounts	(26,989)	–	(26,989)	(17,546)	–	–	(44,535)
Net patient services revenue	1,061,744	–	1,061,744	535,197	29,244	(7,285)	1,618,900
Research grants and contracts	187,023	–	187,023	–	–	(9,713)	177,310
Recovery of indirect costs on grants and contracts	65,864	–	65,864	–	–	(2,698)	63,166
Other operating revenue	49,356	4,129	53,485	–	16,283	17,484	87,252
Unrestricted contributions, net of fundraising expenses	9,009	–	9,009	–	–	(70)	8,939
Research revenue	–	–	–	40,582	–	(40,582)	–
Clinical and other revenue	–	–	–	38,841	–	(38,841)	–
Teaching, administration and supervision revenue	–	–	–	9,180	–	(9,180)	–
Net assets released from restriction used for operations	47,875	–	47,875	14,475	–	(15,610)	46,740
Total revenues	1,420,871	4,129	1,425,000	638,275	45,527	(106,495)	2,002,307
Expenses:							
Salaries and benefits	618,948	(67)	618,881	483,588	26,712	4,302	1,133,483
Supplies and other expenses	427,598	383	427,981	41,484	17,138	(19,371)	467,232
Direct research expenses of grants	187,023	–	187,023	–	–	(9,713)	177,310
Health Safety Net assessment	8,570	–	8,570	–	–	–	8,570
Medical service expenses	–	–	–	23,672	–	(23,672)	–
Research expenses	–	–	–	33,317	–	(33,317)	–
Contributions	–	–	–	19,994	–	(19,994)	–
Depreciation and amortization	106,853	689	107,542	1,064	5,440	–	114,046
Interest and net interest rate swap cash flows	34,228	–	34,228	–	6	–	34,234
Total expenses	1,383,220	1,005	1,384,225	603,119	49,296	(101,765)	1,934,875
Gain (loss) from operations	37,651	3,124	40,775	35,156	(3,769)	(4,730)	67,432
Non-operating gains (losses):							
Income from investments	8,910	13,194	22,104	13,083	1,031	21,986	58,204
Net realized gain on investments	3,003	74,659	77,662	12,622	(38)	–	90,246
Unrealized gain on investments classified as trading securities	–	–	–	(26,408)	–	–	(26,408)
Increase in value of alternative investments	16	6,498	6,514	(10,289)	–	1,885	(1,890)
Recognition of unrealized losses on investments	(2,835)	(78,867)	(81,702)	–	–	(14,525)	(96,227)
Fundraising expenses on restricted contributions	(18,542)	–	(18,542)	–	–	–	(18,542)
Adjustment of interest rate swaps to fair value	(33,579)	–	(33,579)	–	–	–	(33,579)
Other non-operating losses	(89)	(7,653)	(7,742)	(46)	–	–	(7,788)
Total non-operating (losses) gains	(43,116)	7,831	(35,285)	(11,038)	993	9,346	(35,984)
(Deficiency) excess of revenues over expenses	\$ (5,465)	\$ 10,955	\$ 5,490	\$ 24,118	\$ (2,776)	\$ 4,616	\$ 31,448

See accompanying independent auditors' report on other financial information.

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