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SHRINERS HOSPITALS FOR CHILDREN

Combined Financial Statements

December 31, 2018

(With Independent Auditors' Report Thereon)

SHRINERS HOSPITALS FOR CHILDREN

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KPMG LLP
Suite 1700
100 North Tampa Street
Tampa, FL 33602-5145

Independent Auditors' Report

The Board of Directors
Shriners Hospitals for Children:

We have audited the accompanying combined financial statements of Shriners Hospitals for Children, which comprise the combined statement of financial position as of December 31, 2018, and the related combined statement of operations and changes in net assets and cash flows for the year then ended, and the related notes to the combined financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the combined financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the combined 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 combined 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 combined financial statements.

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

Opinion

In our opinion, the combined financial statements referred to above present fairly in all material respects, the financial position of Shriners Hospitals for Children as of December 31, 2018, and the changes in their net assets and their cash flows for the year then ended in accordance with U.S. generally accepted accounting principles.

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Emphasis of Matter

As discussed in Note 1(s) to the combined financial statements, Shriners Hospitals for Children adopted the provisions of Financial Accounting Standards Board Accounting Standard Update 2016-14, *Presentation of Financial Statements for Not-For-Profit Entities (ASC 958),* during 2018. Our opinion was not modified with respect to this matter.

KPMG LLP

April 10, 2019

SHRINERS HOSPITALS FOR CHILDREN

Combined Statement of Financial Position

December 31, 2018

(In thousands)

Assets		
Cash and cash equivalents	$	42,723
Cash and cash equivalents held as collateral under securities lending transactions		429,663
Patient accounts receivable, net of allowance for doubtful accounts of approximately $94,508 in 2018		31,256
Receivables, net		10,985
Accrued interest and dividends		23,811
Inventories and deferred charges		38,370
Patient transportation funds held by Shrine temples		67,474
Long-term investments:		
Marketable securities		6,883,443
Charitable gift annuities		43,865
Beneficial interest in trusts		509,442
Real estate and mineral interests		306,696
Miscellaneous investments		24,257
Estates in process		254,995
Land, buildings, and equipment, net of accumulated depreciation		898,303
Total assets	$	9,565,283
Liabilities and Net Assets		
Liabilities:		
Accounts payable and accrued expenses	$	153,079
Pension and postretirement benefits		222,998
Liabilities under securities lending transactions		429,663
Other liabilities		41,810
Total liabilities		847,550
Net assets		
Without donor restrictions (net of cumulative foreign currency translation adjustment of $9,425 in 2018):		7,385,912
With donor restrictions		1,331,821
Total net assets		8,717,733
Total liabilities and net assets	$	9,565,283

See accompanying notes to combined financial statements.

SHRINERS HOSPITALS FOR CHILDREN

Combined Statement of Operations and Changes in Net Assets

Year ended December 31, 2018

(In thousands)

	Without donor restrictions	With donor restrictions	Total
Operating revenues and other support:			
Patient service revenue (net of contractual adjustments)	$ 207,413	—	207,413
Provision for Shriners assist	(54,635)	—	(54,635)
Net patient service revenue less provision for Shriners assist	152,778	—	152,778
Investment income:			
Interest	76,572	—	76,572
Dividends	96,409	—	96,409
Other investment income	40,688	—	40,688
Investment management fees	(19,505)	—	(19,505)
Amounts released from restrictions used for operations	143,514	(143,514)	—
Bequests	92,103	105,014	197,117
Donations	168,970	5,246	174,216
Fund raising and special events	60,726	—	60,726
Hospital assessments	967	—	967
Reimbursements from Canadian Provinces	16,344	—	16,344
Other governmental revenue	15,620	—	15,620
Other	4,234	—	4,234
Total revenues and other support	849,420	(33,254)	816,166
Operating expenses:			
Hospitals	693,875	—	693,875
Research	34,877	—	34,877
Revenue cycle	16,080	—	16,080
Information systems	37,112	—	37,112
Headquarters, administrative, and board related	71,912	—	71,912
Donor relations, fund raising and special events	76,915	—	76,915
Total operating expenses	930,771	—	930,771
Decrease in net assets from operating activities	(81,351)	(33,254)	(114,605)
Nonoperating gains (losses), net:			
Gains (losses) on investments:			
Net realized gain from investments	206,837	3,142	209,979
Net unrealized losses on investments	(782,627)	(59,561)	(842,188)
Total losses on investments, net	(575,790)	(56,419)	(632,209)
Life memberships	103	—	103
Change in patient transportation funds held by Shrine temples	—	640	640
Pension-related changes other than net periodic pension costs	(12,290)	—	(12,290)
Other, net	(17,212)	—	(17,212)
Foreign currency translation adjustments	(7)	—	(7)
Total nonoperating losses, net	(605,196)	(55,779)	(660,975)
Decrease in net assets	(686,547)	(89,033)	(775,580)
Net assets, beginning of year	8,072,459	1,420,854	9,493,313
Net assets, end of year	$ 7,385,912	1,331,821	8,717,733

See accompanying notes to combined financial statements.

SHRINERS HOSPITALS FOR CHILDREN

Combined Statement of Cash Flows

Year ended December 31, 2018

(In thousands)

Cash flows from operating activities:		
Decrease in net assets	$	(775,580)
Adjustments to reconcile decrease in net assets to net cash used in operating activities:		
Depreciation		50,213
Loss on disposal of property and equipment		8,689
Realized and unrealized losses on investments		632,209
Gifts, bequests, and life memberships designated by the board or restricted by donor for long-term investment		(197,220)
Change in value of patient transportation funds held by Shrine temples		(640)
Provision for Shriners assist		54,635
Pension related changes other than net period pension costs		(12,290)
Changes in beneficial interest in trusts		62,661
Changes in estates in process		(31,149)
Changes in operating assets and liabilities:		
Net patient accounts receivable		(48,252)
Net receivables		334
Accrued interest and dividends		(2,075)
Inventories and deferred charges		(7,994)
Accounts payable and accrued expenses		(3,121)
Pension and postretirement benefits		22,819
Net cash used in operating activities		(246,761)
Cash flows from investing activities:		
Purchases of property and equipment		(33,105)
Proceeds from sale of investments		2,425,523
Investment purchases		(2,331,669)
Net cash provided by investing activities		60,749
Cash flows from financing activities:		
Gifts and bequests		197,117
Life memberships		103
Borrowings from line of credit		135,000
Payments on the line of credit		(135,000)
Change in other liabilities		1,537
Net cash provided by financing activities		198,757
Net increase in cash and cash equivalents		12,745
Cash and cash equivalents at beginning of year		29,978
Cash and cash equivalents at end of year	$	42,723

See accompanying notes to combined financial statements.

(1) Summary of Significant Accounting Policies

(a) Combined Organizations

Shriners Hospitals for Children (herein SHC) provides quality, specialized medical care, in the areas of orthopedics, severe burns, and spinal cord injuries, through a network of 22 facilities located throughout the United States, Canada, and Mexico. Medical care is provided regardless of the patient or family's ability to pay. SHC also funds intensive programs in pediatric orthopedic and burns research. SHC relies principally on gifts and investment earnings to support their operations and research programs.

The combined financial statements of SHC include the following organizations:

- Shriners Hospitals for Children, a Colorado Corporation
- Shriners Hospitals for Children, a Canadian Corporation
- Shriners Hospitals for Children (Quebec) Inc.
- The Shriners' Hospital for Children, a Massachusetts Corporation
- Shriners Hospitals for Children, a Mexican Association
- Shriners Hospitals for Children Pediatric Orthotic and Prosthetic LLCs (POPS)

Shriners Hospitals for Children, a Colorado Corporation and The Shriners' Hospital for Children, a Massachusetts Corporation, have been recognized as exempt from U.S. federal income tax on related income under Section 501(a) of the Internal Revenue Code as an organization described in Section 501(c)(3) of the Internal Revenue Code. The Canadian and Quebec Corporations and the Mexican Association are also exempt from income tax on related income in accordance with the laws of their respective countries. Shriners Hospitals for Children POPS are wholly owned limited liability companies that provide orthotic and prosthetic services and related functions.

(b) Use of Estimates

The preparation of the combined financial statements in accordance with generally accepted accounting principles requires management of SHC to make a number of estimates and assumptions that affect the reported amounts in the combined financial statements and accompanying notes to the combined financial statements. Actual results could differ from those estimates.

Significant estimates have been made by management with regard to patient accounts receivable, net of allowance for doubtful accounts, estates in process, and beneficial interest in trusts. These estimates are subject to significant fluctuation due to changes in payment trends and changes that occur in the valuation of assets associated with these estates and trusts and the timing of information received from trustees and executors of these estates and trusts. Actual results could differ materially from these estimates, making it reasonably possible that a material change in these estimates could occur in the near term.

(Continued)

(In thousands)

(c) Basis of Presentation

The combined financial statements are presented on the accrual basis of accounting. Contributions received and unconditional promises to give are measured at their fair values and are reported as increases in net assets. SHC reports gifts of cash and other assets as restricted support if they are received with donor stipulations that limit the use of the donated assets, or if they are designated as support for future periods. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, donor restricted net assets are reclassified to net assets without donor restrictions and reported in the combined statement of operations and changes in net assets as amounts released from restrictions used for operations. Donor-restricted contributions whose restrictions are met in the same reporting period are reported as net assets without donor restrictions.

- Net assets without donor restrictions consist of investments and otherwise unrestricted amounts that are available for use in carrying out the activities of SHC. The majority of net assets without donor restrictions as of December 31, 2018 represent board-designated endowment.
- Net assets with donor restrictions represent those amounts, which are not available until future periods or are donor restricted for specific purposes. SHC reports estates in process, charitable lead trusts, charitable remainder trusts, and patient transportation funds as increases in net assets with restrictions as these assets are not available for expenditure until future periods. SHC also reports gifts and bequests from donors who place restrictions on the use of the funds, which mandate that the original principal be invested in perpetuity as net assets with donor restrictions. This includes perpetual lead trusts.

  Net assets with donor restrictions consists of the following as of December 31, 2018:

Subject to expenditure for a specific purpose:		
Hospitals	$	1,168,072
Research		3,379
Patient Transportation Fund		67,474
		1,238,925
Subject to the passage of time:		
For periods after December 31, 2018		92,896
Total net assets with donor restricitions:	$	1,331,821

(d) Operating Measure

Changes in net assets from operating activities represent the revenues, gains, and other support designated to operate SHC, less expenses and other costs associated with SHC operating and research activities and costs to generate operating revenues.

(e) Liquidity

Assets are presented in the accompanying combined statement of financial position according to their nearness of conversion to cash, and liabilities according to the nearness of their maturity and resulting use of cash.

(f) Cash and Cash Equivalents

SHC considers all highly liquid investments made from operating cash accounts and with a maturity of three months or less when purchased to be cash equivalents.

(g) Securities Loaned

Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 860, *Transfers and Servicing*, requires SHC to recognize cash received as collateral for assets transferred to brokers in security lending transactions along with the obligation to return the cash. SHC generally receives collateral in the form of cash in an amount in excess of the fair value of securities loaned. SHC monitors the fair value of securities loaned on a monthly basis with additional collateral obtained as necessary. At December 31, 2018, SHC held $429,663 of cash and marketable securities as collateral deposits. The collateral is included as both an asset and a liability in SHC's combined statement of financial position. The securities on loan had a fair value of $418,789 at December 31, 2018 and are included in marketable securities in the accompanying combined statement of financial position.

(h) Inventories

Inventories of supplies are stated at the lower of cost (first-in, first-out method) or market.

(i) Long-Term Investments

The following long-term investments comprise SHC's endowment: marketable securities, charitable gift annuities, beneficial interest in trusts, real estate and mineral interests and miscellaneous investments. It is SHC's Board of Directors (the Board) policy to maintain a long-term investment portfolio to support the operating and research activities of SHC.

Marketable securities are measured at fair value based on quoted market prices at the reporting date for these or similar investments. Investments in real estate and mineral interests, and miscellaneous investments are reported at fair value at the date of contribution and subsequently measured at fair value based on various sources of information depending on the asset type. Investment income (including realized and unrealized gains and losses on investments, interest, and dividends) is included in the combined statement of operations and changes in net assets as increases or decreases in net assets without donor restrictions unless the income is restricted by donor or law.

SHC has a beneficial interest in a variety of trust agreements. Many of these trusts are charitable lead trusts where SHC receives distributions from the trust, which in most cases are administered by a third party. Perpetual lead trusts are recorded at the fair value of their underlying assets. All other charitable lead trusts are recorded at the present value of the estimated future distributions expected to be received by SHC, and are classified as net assets with donor restrictions.

Charitable remainder trusts and pooled income funds represent trust agreements where SHC maintains custody of the related assets and makes specified distributions to a designated beneficiary or beneficiaries over the term of the trust. Assets under both types of trusts are recorded at fair value. Annuity liabilities associated with charitable remainder trusts are determined based on the present value of the estimated future payments to be paid to the designated beneficiaries, based upon actuarial estimate. Deferred income is recognized on gifts to pooled income funds representing the discounted value of the assets for the estimated time period until the donor's death. The difference between the recorded assets and the annuity liabilities or deferred income associated with pooled income funds is classified as net assets with donor restrictions.

Subsequent adjustments to the carrying value of the respective assets and related liabilities or deferred income are recognized in the combined statement of operations and changes in net assets and are included in unrealized gains and losses in their respective net asset classification.

Included in other liabilities in the accompanying combined statement of financial position are annuity liabilities of $18,937 and deferred income of $19,460 at December 31, 2018.

(j) Estates in Process

SHC recognizes a receivable and revenue for its interest in estates in process based on the inventories of estate assets and conditions contained in the respective wills. Amounts expected to be received in future years are discounted to provide estimates in current year dollars. SHC records estates in process (when the court declares the related will valid) as either net assets with donor restrictions, as these assets will not be available for expenditures until future periods (typically one to five years), or these assets are restricted in perpetuity. As funds from an estate (other than restricted in perpetuity) are collected, net assets are released from net assets with donor restrictions, and reported in the combined statement of operations and changes in net assets as amounts released from restrictions used for operations.

(k) Land, Buildings, and Equipment

Land, land improvements, buildings, and equipment are stated at cost, if purchased, or at estimated fair value at date of receipt if acquired by gift. Depreciation is calculated using the straight-line method over the estimated useful lives of the assets.

(l) Impairment or Disposal of Long-Lived Assets

SHC accounts for long-lived assets in accordance with the provisions of FASB ASC Section 360-10-35, *Property, Plant, and Equipment – Subsequent Measurement*, which requires that long-lived assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

SHC reviews whether events and circumstances have occurred to indicate if the remaining estimated useful life of long-lived assets may warrant revision or that the remaining balance of an asset may not be recoverable. If such an event occurs, an assessment of possible impairment is based on whether the carrying amount of the asset exceeds the expected total undiscounted cash flows expected to result from the use of the assets and their eventual disposition. No impairments were recorded in 2018.

(m) Foreign Currency Translation

Revenues and expenses of the Canadian and Quebec corporations and the Mexican Association are translated using average exchange rates during the year, while monetary assets and liabilities are translated into U.S. dollars using current exchange rates at the end of the year.

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Nonmonetary asset (land, buildings, and equipment) and liability items and related revenues, expenses, gains, and losses are remeasured using historical exchange rates. Resulting translation adjustments are accumulated in the combined statement of financial position caption “Cumulative foreign currency translation adjustment,” as a component of net assets.

(n) Contributed Services

No amounts have been reflected in the combined financial statements for contributed services. SHC’s programs pay for most services requiring specific expertise. However, many individuals (Shriners and non-Shriners) volunteer their time at SHC and perform a variety of tasks that assist SHC with specific programs and various committee assignments.

(o) Net Patient Service Revenue

Net patient service revenue is reported at estimated net realizable amounts from patients, third-party payors, and others for services. SHC has agreements with third-party payors that provide for payments to SHC at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, and discounted charges.

Revenue from the Medicaid program accounted for approximately 47% for the year ended December 31, 2018. Revenue from the Medicare program accounted for less than one percent of SHC’s net patient service revenue. The composition of patient service revenue (net of contractual adjustments) but before the provision for Shriners assist recognized from these major payor sources is as follows (in thousands):

		2018
Medicaid	$	97,545
Commercial payers		109,868
Total all payors	$	207,413

SHC analyzes its past collection history and identifies trends by each of its major payor sources of patient service revenue to estimate the appropriate allowance for doubtful accounts and provision for Shriners assist. Management regularly reviews data about the major payor sources of patient service revenue in evaluating the adequacy of the allowance for doubtful accounts.

SHC analyzes contractual amounts due from third-party payors and provides an allowance for doubtful accounts and a provision for Shriners assist. For uninsured and Shriners assist patients, which includes those patients without insurance coverage and patients with deductibles and copayment balances for which third-party coverage exists for a portion of the bill, SHC records a significant provision for Shriners assist for patients that are unable to pay for any portion of the bill. Account balances are charged off against the allowance for Shriners assist. SHC has not experienced significant changes in write-off trends and has not changed its uninsured or charity care policies for the year ended December 31, 2018.

(Continued)

(In thousands)

Laws and regulations governing the Medicaid and Medicare programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates associated with these programs will change by a material amount in the near term. As a result, provisions for third-party payor settlements and adjustments are estimated in the period the related services are provided and adjusted in future periods as additional information becomes available and as final settlements are determined or as years are no longer subject to audits, reviews and investigations.

Net patient accounts receivable included approximately $9,773 or 31% from the Medicaid programs as of December 31, 2018. Net patient accounts receivable also included less than one percent from Medicare programs. The credit risk for other concentrations of receivables is limited due to the large number of insurance companies and other payors that provide payments for services.

(p) Charity Care

SHC, through its overall charitable policies, provides funding for cash requirements of the hospitals not met through normal operations. In addition, SHC provides care to patients who meet certain criteria under the charity care policies established by SHC without charge to its patients or families. Partial payments to which SHC is entitled from patients, third-party payors, Medicaid and others that meet SHC's charity care criteria are reported as net patient service revenue.

SHC provides necessary medical care regardless of the patient's ability to pay for services under its charity care policy. In addition, regulatory changes that may have the potential to alter charity classifications are monitored and incorporated into the policy, as necessary. SHC maintains records to identify and monitor the level of charity care. These records include the amount of charges foregone for services and supplies furnished under its charity care policy. The following measures the level of charity care and other community benefits, as defined, at estimated costs for the year ended December 31, 2018:

		2018
Traditional charity care	$	700,673
Direct offsetting revenue		(182,624)
Net traditional charity care	$	518,049
As a percentage of total expense		62%

(q) Disproportionate Share Distributions

In some states in which SHC's hospitals operate the state program for healthcare administration distributes low-income pool and disproportionate share payments to SHC based on its indigent care service level. SHC's policy is to recognize these distributions as revenue when the amounts are due and collection is reasonably assured. The receipt of any additional distributions is contingent upon the continued support provided by the respective state's legislature. SHC recognized $17,693 of

(Continued)

disproportionate share distributions in other governmental revenue within the accompanying combined statement of operation and changes in net assets for the year ended December 31, 2018.

(r) Electronic Health Records Incentive Payments

The American Recovery and Reinvestment Act of 2009 provides for incentive payments under the Medicare and Medicaid programs for certain hospitals and professionals that adopt and use electronic health records (EHR) in a meaningful way. Meaningful use is demonstrated by meeting established criteria that focus on capturing and using electronic health information to improve healthcare quality, efficiency, and patient safety.

SHC records incentive payments when it is reasonably assured that it has met the meaningful use requirements. SHC recognized $2,118 of incentive payments in other governmental revenue within the accompanying combined statement of operations and changes in net assets for the year ended December 31, 2018. Incentive payment revenue is subject to change as the result of audits of compliance with meaningful use criteria and Medicare cost reports, with changes recorded in the period they occur.

(s) Adoption of New Accounting Standards

SHC adopted Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities (ASC 958)* effective January 1, 2018. This standard focuses on improving the current net asset classification requirements and the information presented in financial statements and notes that would be useful in assessing a not-for-profit's liquidity, financial performance, and cash flows. The standard also requires all not-for-profit entities to present expenses by function and nature to help users assess how not-for-profit entities utilize their resources.

As a result of the adoption of ASU 2016-14, approximately $8,072,000 previously reported as unrestricted net assets has been reported as net assets without donor restrictions and approximately $264,000 and $1,155,000 previously reported as temporarily restricted and permanently restricted net assets, respectively, has been reported as net assets with donor restrictions on the combined statement of operations and changes in net assets. As required by ASU 2016-14, expenses are presented by function and nature in note 13. Liquidity and availability of financial assets are discussed in note 14.

(In thousands)

(2) Long-Term Investments

Marketable securities at December 31, 2018 consist of:

		2018	
		Cost	Fair value
Short-term investments	$	296,806	296,806
Common and preferred stocks		3,310,731	3,676,404
U.S. government securities		947,590	945,033
Corporate bonds		519,797	514,529
Other fixed income		663,265	677,734
Commodities fund		245,081	281,457
Fund of funds		489,031	491,480
	$	6,472,301	6,883,443

Investment income and total return on all long-term investments comprise the following components for the years ended December 31, 2018:

		2018
Interest	$	76,572
Dividends		96,409
Trust income		21,697
Rents and royalties		15,503
Other income		3,488
Less investment management fees		(19,505)
Total income from investments		194,164
Net realized gains from investments		209,979
Net unrealized losses from investments		(842,188)
Total return on investments	$	(438,045)

(In thousands)

(3) Land, Buildings, and Equipment

Land, buildings, and equipment at December 31, 2018 consist of:

		2018	Estimated useful lives
Land	$	41,660	—
Land improvements		11,004	5–20 years
Buildings		1,127,686	40–50 years
Equipment		433,387	4–25 years
		1,613,737	
Less accumulated depreciation		(832,591)	
		781,146	
Construction in progress		117,157	
Land, buildings, and equipment, net	$	898,303	

Depreciation expense amounted to $50,213 for the year ended December 31, 2018.

The hospital buildings located in Lexington, Kentucky, St. Louis, Missouri, and Montreal, Canada are classified as held for sale, as the existing hospital operations had been relocated to newly developed facilities. Upon relocation, the existing Lexington, St. Louis and Canada buildings were transferred from land, buildings, and equipment to real estate and mineral interests at their respective remaining net book values.

On February 6, 2018, SHC executed an asset sales agreement related to its hospital building located in St. Louis, Missouri for $16,550. The gain recognized upon sale of the hospital of $4,560 has been reported as a net realized gain from investments within the nonoperating gains and losses on investments section of the combined statement of operations and changes in net assets.

(In thousands)

(4) Construction and Other Major Capital Projects

Construction and other major capital projects committed to by the Board are as follows:

Project		Total appropriation	(Over) or under expended at December 31, 2018
Construction In Process		10,149	4,679
IS Projects		10,644	2,100
Other equipment		27,083	8,587
	$	47,876	15,366

(5) Line of Credit

During 2011, SHC entered into an unsecured line-of-credit agreement, for up to $150 million, with a financial institution for the purpose of aiding in operations and cash management. During December 2018, the line-of-credit agreement was renewed at a limit of $150 million, with an option to increase the limit to $250 million, upon need. On the date of a principal draw, SHC may elect to incur interest at one of two interest rate options. No amount was outstanding at December 31, 2018.

(6) Transactions with Shriners International

SHC was founded by Shriners International. The International Headquarters building and equipment is owned by SHC. A portion of the building is occupied by Shriners International, which is allocated a share of the operating costs and depreciation of the building and equipment. The allocation of the costs is based upon the portion of the building occupied by Shriners International in relation to the total occupied space in the building.

SHC and Shriners International also share other costs based on the estimated fair value received by each organization. Additionally, hospital assessments, donations, and other charitable receipts from Shrine temples are collected and remitted to SHC by Shriners International.

At December 31, 2018, an amount of $3,288 was due from Shriners International and is included in receivables, net in the accompanying combined statement of financial position.

(7) Donor Relations, Fund-Raising Activities, and Special Events

SHC is financially supported through each Shriner’s annual hospital assessment, income from investments, gifts and bequests from the general public and from Shriners, and certain fund-raising activities conducted by Shriners. Shrine temples and Shriners raise funds for both fraternal and charitable purposes. Shrine fund-raising activities consist of paper sale donations, football games, golf tournaments, and other miscellaneous activities. The name “Shriners Hospitals for Children” may be used in connection with a fund-raising activity by a Shrine temple or Shriner only with the written consent of Shriners International

(Continued)

(In thousands)

and SHC when the proceeds are to benefit SHC. Some of these funds are retained by individual Shrine temples for the support of their respective hospital patient transportation fund.

SHC also engages in other fund-raising activities to generate donations and to develop their donor base. These activities are conducted through an agreement with an unrelated third party.

Fund-raising and special events revenues and costs for the year ended December 31, 2018 consist of the following:

		2018
Revenues from Shrine temple sponsored events	$	4,454
Direct mail revenue		48,764
Other revenue		7,508
	$	60,726
Fund-raising costs paid directly by Shrine temples in connection with fund-raising events	$	545
Direct mail expense		21,062
Other costs		14,034
	$	35,641

Revenues from Shrine temple sponsored events are reported net of direct costs of $2,737 for 2018.

In addition to the fund-raising and special events expenses above, SHC incurred $41,274 of donor relation expense for the year ended December 31, 2018. Such expenses are incurred to enhance donor relationships. Donations and bequests from such donors amounted to $371,333 for the year ended December 31, 2018. Such development activities of SHC are overseen by the donor relations committee.

During the year ended December 31, 2008, SHC became the Host Organization and Title Sponsor of a PGA Tour golf tournament. Beginning in 2013, this tournament became part of the Fed-Ex tour. The term of this agreement commenced with the 2008 event and will conclude after the 2020 tournament. The 2018 event yielded $6,606 in revenues. Expenses incurred on this event in 2018 were $12,085, creating a cost of the project of $5,479.

(8) Patient Transportation Funds Held by Shrine Temples

Shrine temples pay for substantially all of the costs of transporting patients to individual Shriners Hospitals from their temple hospital transportation funds. These costs are supported by funds authorized to be retained from fund-raising events held for the benefit of SHC (note 7), as well as local donations from Shriners and the general public. The activities of the Shrine temple patient transportation funds are reflected as a nonoperating change in patient transportation funds held by Shrine temples in the accompanying combined statement of operations and changes in net assets.

(In thousands)

The activities of the patient transportation funds reflected for the years ended December 31, 2018 are as follows:

		2018
Balance, beginning of year	$	66,834
Temple revenues restricted for patient transportation		15,080
Patient transportation costs		(14,440)
Change in patient transportation funds		640
Balance, end of year	$	67,474

(9) Fair Value Measurements

FASB ASC Topic 820, *Fair Value Measurement*, defines fair value as the exit price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market in an orderly transaction between market participants on the measurement date. FASB ASC Topic 820 requires investments to be grouped into three categories based on certain criteria as noted below:

Level 1: Fair value is determined by using quoted prices for identical assets or liabilities in active markets.

Level 2: Fair value is determined by using other than quoted prices that are observable for the asset or liability (e.g., quoted prices for identical assets or liabilities in inactive markets, quoted prices for similar assets or liabilities in active markets, observable inputs other than quoted prices, and inputs derived principally from or corroborated by observable market data by correlation or other means).

Level 3: Fair value is determined by using inputs based on management assumptions that are not directly observable.

(In thousands)

The tables below summarize SHC's significant financial assets and liabilities measured at fair value on a recurring basis as of December 31, 2018:

	December 31, 2018	Fair value measurements at reporting date using		
		Level 1	Level 2	Level 3
Assets:				
Long-term investments:				
Short-term investments	$ 296,806	296,806	—	—
Common and preferred stocks	3,583,437	1,871,528	1,710,913	996
U.S. government securities	945,033	945,033	—	—
Corporate bonds	353,033	—	353,033	—
Other fixed income securities	216,329	—	216,084	245
Commodities fund	196,825	—	196,825	—
Charitable gift annuities	43,865	—	43,865	—
Beneficial interests in trusts	509,442	—	509,442	—
Real estate and mineral interests	306,696	—	—	306,696
Miscellaneous investments	24,257	—	24,257	—
	6,475,723	3,113,367	3,054,419	307,937
Recorded at net asset value	1,291,980			
Total	7,767,703			
Collateral under securities lending transactions	$ 429,663	429,663	—	—
Liabilities:				
Annuity liabilities	$ 18,937	—	18,937	—
Liabilities under securities lending transactions	429,663	429,663	—	—

SHC's Level 1 assets and liabilities include investments in cash, cash equivalents, common and preferred stocks, and U.S. government securities and are valued at quoted market prices.

SHC's Level 2 assets include investments in foreign common and preferred stock, corporate debt securities, other fixed income securities, commodities fund, charitable gift annuities, beneficial interest in trusts, and miscellaneous investments with fair values modeled by external pricing vendors. Liabilities include annuity liabilities.

SHC's Level 3 assets include foreign and domestic common and preferred stocks, real estate and mineral interests, and investments in foreign and domestic corporate bonds.

(In thousands)

The tables below summarize the changes in Level 3 assets for the year ended December 31, 2018:

	Fair value measurements using significant unobservable inputs (Level 3)		
	Common and preferred stock and fixed income investments	**Other investments**	**Total**
2018:			
Beginning balance	$ 795	303,773	304,568
Total gains (realized/unrealized) included in increase in net assets without donor restrictions	—	14,936	14,936
Purchases	—	2,225	2,225
Sales	—	(14,238)	(14,238)
Transfers into/out of Level 3	446	—	446
Ending balance	$ 1,241	306,696	307,937

Realized and unrealized gains included in changes in net assets in Level 3 securities for the year ended December 31, 2018 are reported in investment income as follows:

	2018
Total gains included in increase in net assets without donor restrictions	$ 14,936
Change in unrealized gains (losses) relating to assets still held at reporting date	14,936

SHC's accounting policy is to recognize transfers between levels of the fair value hierarchy on the date the event or change in circumstances that caused the transfer. There were no transfers between Level 1 and Level 2 securities during the year.

(In thousands)

The fair values of the following investments have been estimated using the net asset value per share of the investments as of December 31, 2018.

	December 31, 2018	Redemption frequency	Redemption notice period
WTC CTF Opportunistic Fixed Income (a)	$ 461,405	Monthly	30 days
Capital Guardian Absolute Income (b)	92,968	Monthly	5 days
State Street Fund REIT (c)	51,589	Monthly	15 days
AQR Delta Fund (d)	137,552	Monthly	30 days
Aetos Capital Hedge Funds (d)	232,678	Monthly	30 days
Pyramis Fixed Income Funds (a)	161,496	Monthly	30 days
HarbourVest Doverstreet IX (e)	27,828	N/A	N/A
CVI Credit Value Fund IV (f)	26,776	N/A	N/A
Comvest Capital IV (g)	11,641	N/A	N/A
Private Advisors Small Co (h)	18,387	N/A	N/A
Securis Opportunities Fund (i)	69,660	Semi Annually	90 days
Total	$ 1,291,980		

(a) The fund’s investment objective is an unconstrained, nonbenchmark-oriented investment approach. Bloomberg Barclays Capital U.S. Aggregate Bond Index will be used as the primary reference benchmark.

(b) The investment objective of the fund is to seek a level of income that exceeds the average yield on U.S. stocks generally, to grow such income annually, and to distribute an increasing amount of income per unit of the fund.

(c) The State Street Fund REIT seeks an investment return that approximates the performance of the Dow Jones U.S. select REIT index over the long term. In seeking to accomplish this objective the strategy may invest directly or indirectly in securities and other instruments, including other pooled vehicles of the Trustee.

(d) The fund’s investment objective is to provide a return that exceeds the HFRI fund of funds composite.

(e) Dover Street IX intends to provide investors access to a diversified portfolio of global secondary investments in buyout, growth equity, venture capital, and other private equity assets.

(f) The fund is organized for the purpose of investing in distressed and special opportunity debt investments.

(g) The objective of the partnership is to acquire and actively manage a portfolio of investments primarily consisting of direct commercial loans and other structured financings.

(In thousands)

(h) The fund is organized for the purpose of investing in private equity funds and coinvestments focused on growth equity, buyout, and turnaround strategies.

(i) The fund invests substantially all of its assets in Securis Opportunities Master Fund, whose investment strategy is predominately to own insurance risks, diversified by type of risk and by geography.

(10) Retirement Plans and Other Postretirement Benefits

The employees of the U.S. hospitals are included in the Shriners Hospitals for Children Employees' Retirement Plan and the Shriners Hospitals for Children Supplemental Retirement Plan (collectively, the Pension Plans). Benefits are based on years of service and the employees' compensation during the highest five consecutive years of employment. Contributions are made to the Pension Plans in accordance with ERISA requirements. In addition, SHC sponsors a postretirement life insurance plan (the Postretirement Plan). In March 2009, the Board voted to freeze entry of new participants into the Pension Plans effective May 1, 2009.

The actuarially computed net periodic pension cost for the Pension Plans and the Postretirement Plan for the year ended December 31, 2018 included the following components:

	Pension plans 2018	Postretirement plan 2018
Service cost – benefits earned during the period	$ 20,012	441
Interest cost on projected benefit obligation	28,922	613
Expected return on plan assets	(37,168)	—
Net amortized and deferral of unrecognized gains and losses	16,936	—
Net periodic pension cost	$ 28,702	1,054

(In thousands)

The following table sets forth the Pension Plans' and the Postretirement Plan's funded status and amounts recognized in the combined statement of financial position as of December 31, 2018 (using a measurement date of December 31):

		Pension plans 2018	Postretirement plan 2018
Change in benefit obligation:			
Benefit obligation at beginning of year	$	769,373	16,114
Service cost		20,012	441
Interest cost		28,922	613
Actuarial (gain) loss		(57,591)	(1,941)
Benefits paid		(28,676)	(230)
Benefit obligation at end of year		732,040	14,997

		Pension plans 2018	Postretirement plan 2018
Change in plan assets:			
Fair value of plan assets at beginning of year	$	573,018	—
Actual return on plan assets		(32,689)	—
Employer contributions		12,386	230
Benefits paid		(28,676)	(230)
Fair value of plan assets at end of year		524,039	—
Funded status at end of year	$	(208,001)	(14,997)

The accumulated benefit obligation for the Pension Plans was $656,019 at December 31, 2018. The accumulated benefit obligation differs from the benefit obligation above in that it includes no assumption about future compensation levels. It represents the actuarial present value of future payments to plan participants using current and past compensation levels.

Weighted average assumptions used to determine projected benefit obligations at December 31, 2018 were as follows:

	Pension plans 2018	Postretirement plan 2018
Discount rate	4.25%	4.50%
Rate of compensation increase	3.50	N/A

(In thousands)

Weighted average assumptions used to determine the net periodic benefit costs of the Pension Plans and the Postretirement Plan are:

	Pension plans	Postretirement plan
	2018	2018
Discount rate	3.75%	3.75%
Expected long-term rate of return on plan assets	7.00	N/A
Rate of compensation increase	3.50	N/A

The expected long-term rate of return is based on the portfolio as a whole and not on the sum of the returns on individual asset categories. The return is based exclusively on historical returns, without adjustments.

The following are deferred pension costs, which have not yet been recognized in periodic pension expense but instead are accrued in net assets without donor restrictions as of December 31, 2018. Unrecognized actuarial losses represent unexpected changes in the projected benefit obligation and plan assets over time, primarily due to changes in assumed discount rates and investment experience. Unrecognized prior service cost is the impact of changes in plan benefits applied retrospectively to employee service previously rendered. Deferred pension costs are amortized into annual pension expense over the average remaining assumed service period for active employees.

	Pension plans		Postretirement plan	
	Amounts in net assets without donor restrictions to be recognized during the next fiscal year	Amounts recognized in net assets without donor restrictions at December 31, 2018	Amounts in net assets without donor restrictions to be recognized during the next fiscal year	Amounts recognized in net assets without donor restrictions at December 31, 2018
Actuarial loss	$ 8,291	168,268	—	(1,322)
Prior service cost	814	5,396	—	—
Total	$ 9,105	173,664	—	(1,322)

(In thousands)

(a) Plan Assets

The weighted average allocation of the Pension Plans' assets at December 31, 2018 was as follows:

Asset category	2018
Short-term investments	6%
Common and preferred stock	45
Fixed Income	21
Mutual Funds	28
Total assets	100%

SHC's investment policies and strategies for pension benefits do not use target allocations for the individual asset categories. The Hospitals' investment goals are to maximize returns subject to specific risk management policies.

The table below summarizes the Pension Plans' significant financial assets measured at fair value on a recurring basis as of December 31, 2018:

	December 31, 2018	Fair value measurements at reporting date using Level 1	Level 2
Assets:			
Short-term investments	$ 33,639	33,639	—
Common and preferred stocks	234,787	—	234,787
Corporate and miscellaneous bonds	108,282	—	108,282
Mutual funds	147,331	—	147,331
Total	$ 524,039	33,639	490,400

(b) Contributions

Annual contributions are determined based upon calculations prepared by the plans' actuary. Expected contributions to the Pension Plans and the Postretirement Plan are $14,549 and $477, respectively, in 2019.

(Continued)

(In thousands)

(c) Benefit Payments

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid out of the plans:

	Pension plans	Postretirement plan
Fiscal year(s):		
2019	32,033	477
2020	31,283	502
2021	37,642	527
2022	37,003	553
2023	38,096	580
2024–2028	226,153	3,397

SHC also has a retirement savings plan for all eligible employees. Under this plan, SHC matches 50% of the first 6% of voluntary contributions made from eligible compensation by employees. Matching contributions by SHC to the retirement savings plan were $9,793 in 2018.

Canadian and Mexican hospital employees are included in government retirement programs of their respective countries.

(11) Estimated Malpractice Costs and Other Contingencies

SHC is self-insured for claims attributed to malpractice and workers' compensation from providing professional and patient care services. Claims alleging malpractice have been asserted against SHC and are currently in various stages of litigation. Additional claims may be asserted against SHC arising from services provided to patients through December 31, 2018. Liabilities for malpractice and workers' compensation claims are established based on specific identification and historical experience using actuarial methodologies. It is the opinion of management that estimated malpractice and workers' compensation claims accrued should be adequate to provide for potential losses resulting from both reported claims and claims incurred but not reported. Such amounts are not material and are recorded in accounts payable and accrued expenses on the accompanying combined statement of financial position.

SHC is also a party to various other claims and legal actions arising in the ordinary course of business. Management does not believe that the ultimate outcome of such claims and legal actions will have a material adverse effect on the financial position or activities of SHC.

(Continued)

(12) Endowment Funds

FASB ASC Subtopic 958-205, *Not-for-Profit Entities – Presentation of Financial Statements*, as amended, provides guidance on the net asset classification of donor-restricted endowment funds for a not-for-profit organization that is subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act (UPMIFA). FASB ASC Subtopic 958-205 also requires enhanced disclosures about an organization's endowment funds, whether or not the organization is subject to an enacted version of UPMIFA. These disclosures shall enable users of the combined financial statements to understand the net asset classification, net asset composition, changes in net asset composition, spending policy, and related investment policy of its endowment funds (both donor restricted and board designated). SHC follows the requirements of FASB ASC Subtopic 958-205.

SHC's endowment consists of marketable securities, charitable gift annuities, beneficial interest in trusts, real estate and mineral interests, and miscellaneous investments. The endowment consists of both donor-restricted funds, as well as funds designated by the Board of Trustees to function as endowments.

The Board has interpreted the wishes of donors and Colorado and Massachusetts state law as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, SHC classifies as net assets with donor restrictions (a) the original value of gifts donated, (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 endowment. Gifts given with a restriction of time or purpose are also added to the endowment as net assets with donor restrictions. Upon the passage of time or completion of purpose, these funds are released to net assets without restrictions. Funds designated by the Board as endowment funds are included as unrestricted endowment funds.

Investment Return Objectives, Risk Parameters, and Strategies. SHC has adopted investment and spending policies, approved by the Investment Committee, for endowment assets that attempt to provide a predictable stream of funding to support the hospital system, while also maintaining the purchasing power of those endowment assets over the long term. Accordingly, the investment process seeks to achieve an after-cost total real rate of return, including investment income, as well as capital appreciation, which exceeds the budgeted annual distribution with acceptable levels of risk. Endowment assets are invested in a well-diversified asset mix, which includes equity and fixed-income securities that is intended to result in a rate of return that has sufficient liquidity to provide a high level of cash distribution, while growing the funds, if possible. Therefore, SHC expects its endowment assets, over time, to produce an average rate of return of approximately 7.25% annually. Actual returns in any given year may vary from this amount. Investment risk is measured in terms of the total endowment fund; investment assets and allocation between asset classes and strategies are managed to not expose the fund to unacceptable levels of risk.

Spending Policy. The Board does not have a formal endowment spending policy. Generally, all investment return (excluding capital appreciation) is utilized in funding SHC's programs. In making this funding decision, the Board considers the long-term expected return on its investment assets, the nature and duration of the individual endowment funds, some of which must be maintained in perpetuity because of donor-restrictions, and the possible effects of inflation. The Board's goal is for its endowment funds to grow annually to maintain the purchasing power of the endowment assets, as well as, to provide additional real growth through new gifts and investment return.

(In thousands)

Endowment asset composition by type of fund, as of December 31, 2018, is as follows:

		Without donor restrictions	With donor restrictions	Total endowment assets
2018:				
Board-designated endowment funds	$	7,258,261	—	7,258,261
Donor-restricted endowment funds		—	509,442	509,442
	$	7,258,261	509,442	7,767,703

Changes in endowment assets for the year ended December 31, 2018 are as follows:

		Without donor restrictions	With donor restrictions	Total endowment net assets
2018:				
Balance, beginning of year	$	7,984,324	572,103	8,556,427
Investment income		194,164	—	194,164
Net depreciation		(575,790)	(56,419)	(632,209)
Reclassifications		6,242	(6,242)	—
Withdrawals		(350,679)	—	(350,679)
Balance, end of year	$	7,258,261	509,442	7,767,703

(13) Functional Expenses

SHC's expenses are primarily related to providing the highest quality care to children with neuromusculoskeletal conditions, burn injuries, and other special healthcare needs within a compassionate, family centered and collaborative care environment. SHC receives approximately half of its resources from the general public, approximately 25% from investment earnings, and the remainder from healthcare payors and other means. SHC's accounting policies conform to U.S. generally accepted accounting principles applicable to not-for-profit organizations, as well as requirements for healthcare organizations.

Expenses related to providing these services for the year ended December 31, 2018 are reflected in the table below (in thousands). Amounts below exclude gains and losses on the sale of businesses.

	Year Ended December 31, 2018					
		Hospital Expense	Research Expense	Management and General Expense	Fundraising Expense	Total
Advertising & Promotion	$	2,217	—	512	—	2,729
Benefits		64,521	1,232	13,070	5	78,828
Contributions		—	—	24	—	24
Depreciation		46,507	—	3,706	—	50,213
Dues and Registrations		2,030	34	609	32	2,705
Food supplies		5,057	47	—	—	5,104
Insurance		12,519	—	177	—	12,696
Medical Supplies		91,794	3,229	61	—	95,084
Miscellaneous		3,924	180	5,243	258	9,605
Occupancy		29,298	618	4,188	4	34,108
Office Expense		2,424	269	20,133	77	22,903
Other Fees for Service		73,341	18,055	31,466	53,457	176,319
Patient Costs		4,562	925	822	—	6,309
Payroll taxes		19,434	702	2,803	280	23,219
PGA Event		1,112	18	—	12,085	13,215
Postage		—	—	938	6,663	7,601
Salaries		330,933	9,181	38,681	3,654	382,449
Travel		4,202	387	2,671	400	7,660
Total Operating Expenses	$	693,875	34,877	125,104	76,915	930,771

The financial statements report certain categories of expenses that are attributable to one or more program or supporting functions of SHC. These expenses require allocation on a reasonable basis that is consistently applied. Management and general expenses are those supporting activities that are not directly identifiable with one or more program or fundraising activity. SHC reviews all departments and allocates each department to either program services (hospital and research), management and general, or fundraising based on departmental function.

(Continued)

(14) Liquidity and Availability

SHC has financial assets that could be available within one year of the balance sheet date to meet cash needs for general expenditures. These financial assets consist of cash, accounts receivable, short-term investments and certain non-current investments. While not classified as a current asset, SHC has non-current investments that are available to meet any current needs that may arise. None of the financial assets quantified in the table below are subject to donor or other contractual restrictions that make them unavailable for general expenditure within one year of the balance sheet date. The accounts receivable are expected to be collected within one year. SHC structures its financial assets to be available as its general expenditures, liabilities, and other obligations come due. As more fully described in Note 5, SHC also has a committed line of credit in the amount of $150 million, which it could draw upon in the event of an unanticipated liquidity need. The available liquidity for the year ended December 31, 2018 are as follows (in thousands):

		December 31, 2018
Cash and cash equivalents	$	42,723
Receivables		66,052
Short-term investments		296,806
Non-current investments available within one year		6,586,637
Total	$	6,992,218

(15) Subsequent Events

SHC has evaluated events and transactions occurring subsequent to December 31, 2018 as of April 10, 2019, which is the date the combined financial statements were available to be issued. Management believes that no additional material events have occurred since December 31, 2018 that require recognition or disclosure in the combined financial statements.