



SHRINERS HOSPITALS FOR CHILDREN
Combined Financial Statements and Schedules
December 31, 2019
(With Independent Auditors' Report Thereon)

SHRINERS HOSPITALS FOR CHILDREN

Table of Contents

| | Page |
|--|-------------|
| Independent Auditors' Report | 1 |
| Combined Statement of Financial Position | 3 |
| Combined Statement of Operations and Changes in Net Assets | 4 |
| Combined Statement of Cash Flows | 5 |
| Notes to Combined Financial Statements | 6 |



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, 2019, and the related combined statements 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, 2019, 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.



Emphasis of Matter

As discussed in Note 1(s) to the combined financial statements, Shriners Hospitals for Children adopted Financial Accounting Standards Board Accounting Standard Update 2014-09, *Revenue from Contracts with Customers (ASC 606)*, as amended, during 2019. Our opinion is not modified with respect to this matter.

KPMG LLP

April 15, 2020

SHRINERS HOSPITALS FOR CHILDREN

Combined Statement of Financial Position

December 31, 2019

(In thousands)

Assets

| | | |
|--|----|-------------------|
| Cash and cash equivalents | \$ | 40,980 |
| Cash and cash equivalents held as collateral under securities lending transactions | | 531,229 |
| Patient accounts receivable | | 28,467 |
| Receivables, net | | 12,448 |
| Accrued interest and dividends | | 21,859 |
| Inventories and deferred charges | | 40,033 |
| Patient transportation funds held by Shrine temples | | 70,477 |
| Investments: | | |
| Marketable securities | | 7,769,561 |
| Charitable gift annuities | | 48,098 |
| Beneficial interest in trusts | | 574,397 |
| Real estate and mineral interests | | 288,715 |
| Miscellaneous investments | | 31,122 |
| Estates in process | | 249,788 |
| Land, buildings, and equipment, net of accumulated depreciation | | 875,945 |
| Total assets | \$ | <u>10,583,119</u> |

Liabilities and Net Assets

| | | |
|--|----|-------------------|
| Liabilities: | | |
| Accounts payable and accrued expenses | \$ | 152,298 |
| Pension and postretirement benefits | | 242,126 |
| Liabilities under securities lending transactions | | 531,229 |
| Other liabilities | | 41,681 |
| Total liabilities | | <u>967,334</u> |
| Net assets: | | |
| Without donor restrictions (net of cumulative foreign currency translation adjustment of \$9,351) | | 8,239,945 |
| With donor restrictions | | 1,375,840 |
| Total net assets | | <u>9,615,785</u> |
| Total liabilities and net assets | \$ | <u>10,583,119</u> |

See accompanying notes to combined financial statements.

SHRINERS HOSPITALS FOR CHILDREN

Combined Statement of Operations and Changes in Net Assets

Year ended December 31, 2019

(In thousands)

| | <u>Without donor restrictions</u> | <u>With donor restrictions</u> | <u>Total</u> |
|---|---------------------------------------|------------------------------------|------------------|
| Operating revenues and other support: | | | |
| Net patient service revenue | \$ 153,586 | — | 153,586 |
| Investment income: | | | |
| Interest | 91,316 | — | 91,316 |
| Dividends | 104,917 | — | 104,917 |
| Net realized gain from investments | 83,048 | 1,021 | 84,069 |
| Other investment income | 40,079 | — | 40,079 |
| Investment management fees | (20,413) | — | (20,413) |
| Amounts released from restrictions used for operations | 111,884 | (111,884) | — |
| Bequests | 85,335 | 82,277 | 167,612 |
| Donations | 164,614 | 1,861 | 166,475 |
| Fund raising and special events | 65,439 | — | 65,439 |
| Hospital assessments | 923 | — | 923 |
| Reimbursements from Canadian Provinces | 20,883 | — | 20,883 |
| Other governmental revenue | 18,381 | — | 18,381 |
| Other | 6,178 | — | 6,178 |
| | <u>926,170</u> | <u>(26,725)</u> | <u>899,445</u> |
| Total revenues and other support | | | |
| Operating expenses: | | | |
| Hospitals | 711,200 | — | 711,200 |
| Research | 30,429 | — | 30,429 |
| Revenue cycle | 15,193 | — | 15,193 |
| Information systems | 39,095 | — | 39,095 |
| Headquarters, administrative, and board related | 87,618 | — | 87,618 |
| Donor relations, fund raising and special events | 85,901 | — | 85,901 |
| | <u>969,436</u> | <u>—</u> | <u>969,436</u> |
| Total operating expenses | | | |
| Decrease in net assets from operating activities | <u>(43,266)</u> | <u>(26,725)</u> | <u>(69,991)</u> |
| Nonoperating gains, net: | | | |
| Net unrealized gains on investments | 943,166 | 67,741 | 1,010,907 |
| Life memberships | 41 | — | 41 |
| Change in patient transportation funds held by Shrine temples | — | 3,003 | 3,003 |
| Pension-related changes other than service costs | (32,194) | — | (32,194) |
| Other, net | (13,640) | — | (13,640) |
| Foreign currency translation adjustments | (74) | — | (74) |
| | <u>897,299</u> | <u>70,744</u> | <u>968,043</u> |
| Total nonoperating gains, net | | | |
| Increase in net assets | 854,033 | 44,019 | 898,052 |
| Net assets, beginning of year | <u>7,385,912</u> | <u>1,331,821</u> | <u>8,717,733</u> |
| Net assets, end of year | <u>\$ 8,239,945</u> | <u>1,375,840</u> | <u>9,615,785</u> |

See accompanying notes to combined financial statements.

SHRINERS HOSPITALS FOR CHILDREN

Combined Statement of Cash Flows

Year ended December 31, 2019

(In thousands)

| | |
|---|-------------------------|
| Cash flows from operating activities: | |
| Increase (decrease) in net assets | \$ 898,052 |
| Adjustments to reconcile increase (decrease) in net assets to net cash used in operating activities: | |
| Depreciation | 61,510 |
| Loss on disposal of property and equipment | 6,178 |
| Realized and unrealized (gains) losses on investments | (1,094,976) |
| Gifts, bequests, and life memberships designated by the board or restricted by donor for long-term investment | (167,653) |
| Change in value of patient transportation funds held by Shrine temples | (3,003) |
| Pension related changes other than service costs | (32,194) |
| Changes in beneficial interest in trusts | (64,955) |
| Changes in estates in process | 5,207 |
| Changes in operating assets and liabilities: | |
| Net patient accounts receivable | 2,789 |
| Net receivables | (1,463) |
| Accrued interest and dividends | 1,952 |
| Inventories and deferred charges | (1,663) |
| Accounts payable and accrued expenses | (781) |
| Pension and postretirement benefits | 51,322 |
| Net cash used in operating activities | <u>(339,678)</u> |
| Cash flows from investing activities: | |
| Purchases of property and equipment | (45,330) |
| Proceeds from sale of investments | 2,431,110 |
| Investment purchases | <u>(2,215,369)</u> |
| Net cash provided by investing activities | <u>170,411</u> |
| Cash flows from financing activities: | |
| Gifts and bequests | 167,612 |
| Life memberships | 41 |
| Borrowings from line of credit | 95,000 |
| Payments on the line of credit | (95,000) |
| Change in other liabilities | <u>(129)</u> |
| Net cash provided by financing activities | <u>167,524</u> |
| Net (decrease) increase in cash and cash equivalents | (1,743) |
| Cash and cash equivalents at beginning of year | <u>42,723</u> |
| Cash and cash equivalents at end of year | \$ <u><u>40,980</u></u> |

See accompanying notes to combined financial statements.

SHRINERS HOSPITALS FOR CHILDREN

Notes to Combined Financial Statements

December 31, 2019

(In thousands)

(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 Ambulatory Clinic, 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 and Tijuana Associations 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 by SHC Colorado Corporation as 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, 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.

SHRINERS HOSPITALS FOR CHILDREN

Notes to Combined Financial Statements

December 31, 2019

(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, 2019 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, 2019:

| | |
|--|---------------------|
| Subject to expenditure for a specific purpose: | |
| Hospitals | \$ 1,207,574 |
| Research | 2,443 |
| Patient Transportation Fund | <u>70,477</u> |
| | 1,280,494 |
| Subject to the passage of time | <u>95,346</u> |
| Total net assets with donor restrictions | <u>\$ 1,375,840</u> |

(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.

SHRINERS HOSPITALS FOR CHILDREN

Notes to Combined Financial Statements

December 31, 2019

(In thousands)

(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, 2019, SHC held \$531,229 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 \$508,101 at December 31, 2019 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) Investments

The following 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 an 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, of both time and purpose.

SHRINERS HOSPITALS FOR CHILDREN

Notes to Combined Financial Statements

December 31, 2019

(In thousands)

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 \$19,452 and deferred income of \$18,608 at December 31, 2019.

(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

SHRINERS HOSPITALS FOR CHILDREN

Notes to Combined Financial Statements

December 31, 2019

(In thousands)

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 2019.

(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.

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

SHC's revenues are derived from contracts with patients in which the performance obligation is to provide health care services to the patients and are reported at the amount expected to be received in exchange for providing patient care. These amounts are due from patients, third-party payors (including managed care payors and government programs) and others, and they include variable consideration for retroactive adjustments due to settlement of audits, reviews and investigations. Generally, SHC bills patients and third-party payors several days after services are performed or shortly after discharge. SHC identified performance obligations based on the nature of services provided and recognizes the revenue as the performance obligations are satisfied. Inpatient acute care services satisfied over time, generally from admission to time of discharge, are recognized based on actual charges incurred in relation to the total expected (or actual) charges, which depicts the transfer of health care services over the duration of the performance obligation. Revenue for performance obligations satisfied at a point in time, which is generally relating to patients receiving outpatient services, is recognized when services are provided and SHC does not believe the patient requires additional services.

The transaction price is determined based on gross charges for services provided, reduced by contractual adjustments to third-party payors, discounts provided to uninsured patients, and implicit price concessions. The payment arrangements with third-party payors for the services SHC provides typically specify payments to SHC at amounts different from the established rates. Payment arrangements include prospectively determined rates per discharged, reimbursed costs, discounted charges, and per diem payments. Generally, patients covered by third-party payors are responsible for related deductibles and coinsurance, which is referred to as the patient portion.

SHRINERS HOSPITALS FOR CHILDREN

Notes to Combined Financial Statements

December 31, 2019

(In thousands)

SHC determines the estimates of contractual adjustments and discounts based on contractual agreements, SHC's Patient Discount Policy, as well as historical experience and other collection indicators. Consistent with SHC's mission, care is provided to patients regardless of their ability to pay. Therefore, SHC has determined it has provided implicit price concessions to uninsured patients and patients with other uninsured balances (for example, copays and deductibles). The implicit price concessions included in estimating the transaction price represent the difference between the amounts billed to the patients and the amounts SHC expects to collect based on its collection history with those patients and current market conditions. SHC estimates contractual adjustments, discounts and implicit price concessions utilizing a portfolio approach as a practical expedient to account for patient contracts with similar characteristics as a collective group rather than individually. The financial statement effects of using this practical expedient are not materially different from an individual contract approach.

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

Revenue from the Medicaid program accounted for approximately 56% for the year ended December 31, 2019. Revenue from the Medicare program accounted for less than one percent of SHC's net patient service revenue. Patient service revenue (net of contractual adjustments and implicit price concessions) recognized for the year ended December 31, 2019 from the major payor sources is as follows:

| | | |
|-------------------|----|-----------------------|
| Medicaid | \$ | 86,666 |
| Commercial payers | | <u>66,920</u> |
| Total all payors | \$ | <u><u>153,586</u></u> |

Net patient accounts receivable included approximately \$10,932 or 38% from the Medicaid programs as of December 31, 2019. 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.

SHRINERS HOSPITALS FOR CHILDREN

Notes to Combined Financial Statements

December 31, 2019

(In thousands)

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, 2019:

| | | |
|------------------------------|----|------------------|
| Traditional charity care | \$ | 711,200 |
| Direct offsetting revenue | | <u>(192,850)</u> |
| Net traditional charity care | \$ | <u>518,350</u> |

(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 \$17,858 of disproportionate share distributions in other governmental revenue within the accompanying combined statement of operations and changes in net assets for the year ended December 31, 2019.

(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 \$513 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, 2019. 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

Effective January 1, 2019, SHC adopted the FASB Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers (ASC 606)* using a full retrospective method. The standard presents a comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance. The core principle of the model is that an entity should recognize revenue to depict the transfer of promised goods or services to

SHRINERS HOSPITALS FOR CHILDREN

Notes to Combined Financial Statements

December 31, 2019

(In thousands)

customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

SHC's most significant impact of adopting the new standard is to the presentation of the combined statement of operations and changes in net assets related to uninsured and underinsured patients. In accordance with the new standard, SHC now recognizes the majority of its previously reported provision for bad debts as a direct reduction to net patient service revenue as an implicit price concession rather than a separate line item to arrive at net patient service revenue. For the year ended December 31, 2019, SHC recorded approximately \$55,947 of implicit concessions as a direct reduction of net patient service revenue that would have been recorded as provision for Shriners assist prior to the adoption of ASC 606.

For the year ended December 31, 2019, SHC recorded approximately \$162,579 as a direct reduction of patient accounts receivable that would have been reflected as allowance for uncollectable accounts prior to the adoption of ASC 606. SHC has also amended the related presentation of the allowance for doubtful accounts on the combined statement of financial position. Other than these changes in presentation, the adoption of ASC 606 did not have a material impact on the combined statement of financial position or combined statement of operations and changes in net assets for the year ended December 31, 2019. Please see further information in footnote 1(o), related to revenue recognition and accounts receivable policies.

In 2019, SHC adopted FASB ASU 2017-07, *Compensation – Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. This ASU requires organizations to present the service cost component of net benefit cost in the statement of operations line items where they report compensation costs. Organizations are to present all other net benefit cost components outside of income from operations, if one is presented. The impact of adopting this ASU was immaterial to the combined financial statements.

In June 2018, the FASB ASU 2018-08, *Not-For-Profit Entities, Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*. The guidance in this ASU applies to all entities that receive or make contributions. The ASU clarifies the definition of an exchange transaction and clarifies the criteria for evaluating whether contributions are unconditional (and thus recognized immediately in income) or conditional (for which income recognition is deferred). The focus is whether a gift or grant agreement both (1) specifies a "barrier" that the recipient must overcome to be entitled to the resources and (2) releases the donor from its obligation to transfer resources if the barrier is not achieved. An agreement that contains both is a conditional contribution. An agreement that omits one or both is unconditional. No new disclosures are required as a result of this ASU. This ASU was effective for SHC's as of December 31, 2019 with no impacts on the combined financial statements.

SHRINERS HOSPITALS FOR CHILDREN

Notes to Combined Financial Statements

December 31, 2019

(In thousands)

(2) Investments

Marketable securities at December 31, 2019 consist of:

| | <u>Cost</u> | <u>Fair value</u> |
|-----------------------------|---------------------|-------------------|
| Short-term investments | \$ 141,184 | 141,184 |
| Common and preferred stocks | 3,307,848 | 4,416,561 |
| U.S. government securities | 929,029 | 975,239 |
| Corporate bonds | 491,182 | 522,024 |
| Other fixed income | 682,377 | 731,820 |
| Commodities fund | 325,543 | 398,373 |
| Fund of funds | 540,111 | 584,360 |
| | <u>\$ 6,417,274</u> | <u>7,769,561</u> |

Investment income and total return on all investments comprise the following components for the year ended December 31, 2019:

| | |
|--|---------------------|
| Interest | \$ 91,316 |
| Dividends | 104,917 |
| Trust income | 22,180 |
| Rents and royalties | 13,602 |
| Other income | 4,297 |
| Less investment management fees | <u>(20,413)</u> |
| Total income from investments | 215,899 |
| Net realized gains from investments | 84,069 |
| Net unrealized gains (losses) from investments | <u>1,010,907</u> |
| Total return on investments | <u>\$ 1,310,875</u> |

SHRINERS HOSPITALS FOR CHILDREN

Notes to Combined Financial Statements

December 31, 2019

(In thousands)

(3) Land, Buildings, and Equipment

Land, buildings, and equipment at December 31, 2019 consist of:

| | <u>2019</u> | <u>Estimated useful lives</u> |
|-------------------------------------|-------------------|-----------------------------------|
| Land | \$ 42,420 | — |
| Land improvements | 11,240 | 5–20 years |
| Buildings | 1,132,370 | 40–50 years |
| Equipment | <u>444,295</u> | 4–25 years |
| | 1,630,325 | |
| Less accumulated depreciation | <u>(883,577)</u> | |
| | 746,748 | |
| Construction in progress | <u>129,197</u> | |
| Land, buildings, and equipment, net | <u>\$ 875,945</u> | |

Depreciation expense amounted to \$61,510 for the year ended December 31, 2019.

The hospital building located in Lexington, Kentucky is classified as held for sale, as the existing hospital operations have been relocated to a newly developed facility. Upon relocation, the existing Lexington building was transferred from land, buildings, and equipment to real estate and mineral interests at its remaining net book value.

On December 16, 2019, SHC executed an asset sales agreement related to its hospital building located in Montreal, Canada for \$17,500. This hospital building was held for sale and recorded in real estate and mineral interested on the accompanying combined statement of financial position. The gain recognized upon sale of the hospital of \$8,394 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.

SHRINERS HOSPITALS FOR CHILDREN

Notes to Combined Financial Statements

December 31, 2019

(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, 2019 |
|-------------------------|------------------------|--|
| Construction in process | \$ 59,438 | 48,692 |
| IS Projects | 25,239 | 9,418 |
| Other equipment | 29,192 | 16,724 |
| | \$ 113,869 | 74,834 |

(5) Line of Credit

In 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. In 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, 2019.

(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, 2019, an amount of \$1,054 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 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.

SHRINERS HOSPITALS FOR CHILDREN

Notes to Combined Financial Statements

December 31, 2019

(In thousands)

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, 2019 consist of the following:

| | | |
|---|----|---------------|
| Revenues from Shrine temple sponsored events | \$ | 5,846 |
| Direct mail revenue | | 51,459 |
| Other revenue | | 8,134 |
| | \$ | <u>65,439</u> |
| Fund-raising costs paid directly by Shrine temples in connection with fund-raising events | \$ | 504 |
| Direct mail expense | | 24,165 |
| Other costs | | 14,772 |
| | \$ | <u>39,441</u> |

Revenues from Shrine temple sponsored events are reported net of direct costs of \$2,857 for 2019.

In addition to the fund-raising and special events expenses above, SHC incurred \$46,460 of donor relation expense for the year ended December 31, 2019. Such expenses are incurred to enhance donor relationships. Donations and bequests from such donors amounted to \$334,087 for the year ended December 31, 2019. 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 2019 event yielded \$7,051 in revenues. Expenses incurred on this event in 2019 were \$12,109, creating a cost of the project of \$5,058.

(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.

SHRINERS HOSPITALS FOR CHILDREN

Notes to Combined Financial Statements

December 31, 2019

(In thousands)

The activities of the patient transportation funds reflected for the year ended December 31, 2019 are as follows:

| | | |
|---|----|----------------------|
| Balance, beginning of year | \$ | 67,474 |
| Temple revenues restricted for patient transportation | | 14,471 |
| Patient transportation costs | | <u>(11,468)</u> |
| Change in patient transportation funds | | <u>3,003</u> |
| Balance, end of year | \$ | <u><u>70,477</u></u> |

(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.

SHRINERS HOSPITALS FOR CHILDREN

Notes to Combined Financial Statements

December 31, 2019

(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, 2019:

| | December 31, 2019 | Fair value measurements at reporting date using | | |
|---|----------------------------|--|------------------|----------------|
| | | Level 1 | Level 2 | Level 3 |
| Assets: | | | | |
| Investments: | | | | |
| Short-term investments | \$ 141,184 | 141,184 | — | — |
| Common and preferred stocks | 4,416,561 | 2,738,586 | 1,677,975 | — |
| U.S. government securities | 975,239 | 975,239 | — | — |
| Corporate bonds | 344,826 | — | 344,826 | — |
| Other fixed income securities | 243,117 | 11,161 | 231,221 | 735 |
| Commodities fund | 232,648 | — | 232,648 | — |
| Charitable gift annuities | 48,098 | — | 48,098 | — |
| Beneficial interests in trusts | 574,397 | — | 574,397 | — |
| Real estate and mineral interests | 288,715 | — | — | 288,715 |
| Miscellaneous investments | 31,122 | — | 31,122 | — |
| | <u>7,295,907</u> | <u>3,866,170</u> | <u>3,140,287</u> | <u>289,450</u> |
| Recorded at net asset value | <u>1,415,986</u> | | | |
| Total | \$ <u>8,711,893</u> | | | |
| Collateral under securities lending transactions | \$ 531,229 | 531,229 | — | — |
| Liabilities: | | | | |
| Annuity liabilities | \$ 19,452 | — | 19,452 | — |
| Liabilities under securities lending transactions | 531,229 | 531,229 | — | — |

SHC's Level 1 assets and liabilities include investments in cash, cash equivalents, common and preferred stocks, U.S. government securities and other fixed income 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 real estate and mineral interests and investments in foreign and domestic corporate bonds.

SHRINERS HOSPITALS FOR CHILDREN

Notes to Combined Financial Statements

December 31, 2019

(In thousands)

The tables below summarize the changes in Level 3 assets for the year ended December 31, 2019:

| | Fair value measurements using significant unobservable inputs (Level 3) | | |
|--|--|--------------------------|----------------|
| | Common and preferred stock and fixed income investments | Other investments | Total |
| 2019: | | | |
| Beginning balance | \$ 1,241 | 306,696 | 307,937 |
| Total gains (losses) (realized/unrealized) included in increase in net assets without donor restrictions | 71 | (11,429) | (11,358) |
| Purchases | 527 | 8,973 | 9,500 |
| Sales | (1,104) | (15,525) | (16,629) |
| Transfers into/out of Level 3 | — | — | — |
| Ending balance | <u>\$ 735</u> | <u>288,715</u> | <u>289,450</u> |

Realized and unrealized gains included in changes in net assets in Level 3 securities for the year ended December 31, 2019 are reported in investment income as follows:

| | |
|---|-------------|
| Total losses included in increase in net assets without donor restrictions | \$ (11,358) |
| Change in unrealized losses relating to assets still held at reporting date | (11,358) |

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.

SHRINERS HOSPITALS FOR CHILDREN

Notes to Combined Financial Statements

December 31, 2019

(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, 2019.

| | Fair value December 31, 2019 | Redemption frequency | Redemption notice period |
|--|---|---------------------------------|-------------------------------------|
| WTC CTF Opportunistic Fixed Income (a) | \$ 488,702 | Monthly | 30 days |
| Pyramis Fixed Income Funds (a) | 177,198 | Monthly | 30 days |
| Windjammer Senior Equity Fund (b) | 3,285 | N/A | N/A |
| State Street Fund REIT (c) | 58,384 | Monthly | 15 days |
| Aetos Capital Hedge Funds (d) | 253,821 | Monthly | 30 days |
| HarbourVest Doverstreet IX (e) | 36,773 | N/A | N/A |
| CVI Credit Value Fund IV (f) | 59,671 | N/A | N/A |
| Comvest Capital IV (g) | 23,924 | N/A | N/A |
| Private Advisors Small Co Funds (h) | 29,107 | N/A | N/A |
| Securis Opportunities Fund (i) | 70,581 | Semi Annually | 90 days |
| Magnitude International (j) | 100,856 | N/A | N/A |
| CF Pinehurst Institutional (k) | 100,718 | N/A | N/A |
| Brookfield Capital Partners V (l) | 5,117 | N/A | N/A |
| Apollo Investment Fund IX, (m) | 3,823 | N/A | N/A |
| HarbourVest Co-Investment V (n) | 4,026 | N/A | N/A |
| Total | \$ <u>1,415,986</u> | | |

- (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 fund is organized for the purpose of investing in making middle market buyout investments primarily in the U.S. and Canada.
- (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 Hedge Fund Research, Inc. (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.

SHRINERS HOSPITALS FOR CHILDREN

Notes to Combined Financial Statements

December 31, 2019

(In thousands)

- (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.
- (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.
- (j) The fund is a fund of hedge funds that will invest primarily in relative value, quantitative, equity volatility, fixed income arbitrage, commodities and trading strategies.
- (k) The fund is a fund of hedge funds that will invest in a diversified set of concentrated managers who hold a portfolio of best ideas in their niche area of focus.
- (l) The fund is organized for the purpose of investing in real asset related businesses.
- (m) The fund is organized for the purpose of investing in a diversified portfolio of companies with a focus on three primary areas: Opportunistic Buyouts, Distressed/Credit, and Corporate Carve-out opportunities.
- (n) The fund is organized for the purpose of investing in a diversified global portfolio of direct co-investments in buyout, growth equity, and other private market transactions.

(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, 2019 included the following components:

| | Pension plans | Postretirement plan |
|---|--------------------------|--------------------------------|
| Service cost – benefits earned during the period | \$ 17,909 | 409 |
| Interest cost on projected benefit obligation | 31,119 | 683 |
| Expected return on plan assets | (35,477) | — |
| Net amortized and deferral of unrecognized gains and losses | 9,107 | — |
| Net periodic pension cost | \$ 22,658 | 1,092 |

SHRINERS HOSPITALS FOR CHILDREN

Notes to Combined Financial Statements

December 31, 2019

(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, 2019 (using a measurement date of December 31):

| | <u>Pension plans</u> | <u>Postretirement plan</u> |
|--|----------------------------|--------------------------------|
| Change in benefit obligation: | | |
| Benefit obligation at beginning of year | \$ 732,040 | 14,997 |
| Service cost | 17,909 | 408 |
| Interest cost | 31,120 | 683 |
| Actuarial loss (gain) | 104,217 | 2,172 |
| Benefits paid | <u>(31,919)</u> | <u>(280)</u> |
| Benefit obligation at end of year | <u>853,367</u> | <u>17,980</u> |
| Change in plan assets: | | |
| Fair value of plan assets at beginning of year | 524,039 | — |
| Actual return on plan assets | 114,094 | — |
| Employer contributions | 23,007 | 280 |
| Benefits paid | <u>(31,919)</u> | <u>(280)</u> |
| Fair value of plan assets at end of year | <u>629,221</u> | <u>—</u> |
| Funded status at end of year | \$ <u><u>(224,146)</u></u> | \$ <u><u>(17,980)</u></u> |

The accumulated benefit obligation for the Pension Plans was \$764,691 at December 31, 2019. 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, 2019 were as follows:

| | <u>Pension plans</u> | <u>Postretirement plan</u> |
|-------------------------------|--------------------------|--------------------------------|
| Discount rate | 3.25 % | 3.50 % |
| Rate of compensation increase | 3.50 | N/A |

SHRINERS HOSPITALS FOR CHILDREN

Notes to Combined Financial Statements

December 31, 2019

(In thousands)

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

| | <u>Pension plans</u> | <u>Postretirement plan</u> |
|--|--------------------------|--------------------------------|
| Discount rate | 4.25 % | 4.50 % |
| Expected long-term rate of return on plan assets | 6.50 | 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, 2019. 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.

| | <u>Pension plans</u> | | <u>Postretirement plan</u> | |
|--------------------|--|---|--|---|
| | <u>Amounts in net assets without donor restrictions to be recognized during the next fiscal year</u> | <u>Amounts recognized in net assets without donor restrictions at December 31, 2019</u> | <u>Amounts in net assets without donor restrictions to be recognized during the next fiscal year</u> | <u>Amounts recognized in net assets without donor restrictions at December 31, 2019</u> |
| Actuarial loss | \$ 18,620 | 185,576 | — | 851 |
| Prior service cost | 814 | 4,582 | — | — |
| Total | \$ <u>19,434</u> | <u>190,158</u> | <u>—</u> | <u>851</u> |

SHRINERS HOSPITALS FOR CHILDREN

Notes to Combined Financial Statements

December 31, 2019

(In thousands)

(a) Plan Assets

The weighted average allocation of the Pension Plans' assets at December 31, 2019 was as follows:

| <u>Asset category</u> | <u>2019</u> |
|----------------------------|--------------|
| Short-term investments | 1 % |
| Common stock | 9 |
| U.S. government securities | 19 |
| Common collective trusts | 56 |
| Mutual funds | 15 |
| Total assets | <u>100 %</u> |

SHC's investment policies and strategies for pension benefits do not use target allocations for the individual asset categories. SHC's 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, 2019:

| | <u>December 31,</u> <u>2019</u> | <u>Fair value measurements at</u> <u>reporting date using</u> | |
|----------------------------|------------------------------------|--|----------------|
| | | <u>Level 1</u> | <u>Level 2</u> |
| Assets: | | | |
| Short-term investments | \$ 4,443 | 4,443 | — |
| Common stock | 59,508 | 59,508 | — |
| U.S. government securities | 117,888 | 117,888 | — |
| Common collective trusts | 355,770 | — | 355,770 |
| Mutual funds | 91,612 | 91,612 | — |
| Total | \$ <u>629,221</u> | <u>273,451</u> | <u>355,770</u> |

SHC's level 1 assets include investments in short-term investments, common stock, U.S. government securities, and mutual funds and are valued at quoted market prices.

SHC's level 2 assets include investments in common collective trusts with fair values modeled by external pricing vendors.

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.

SHRINERS HOSPITALS FOR CHILDREN

Notes to Combined Financial Statements

December 31, 2019

(In thousands)

(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 \$16,971 and \$513, respectively, in 2020.

(c) Benefit Payments

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

| | <u>Pension plans</u> | <u>Postretirement plan</u> |
|-----------------|--------------------------|--------------------------------|
| Fiscal year(s): | | |
| 2020 | \$ 31,181 | 513 |
| 2021 | 38,074 | 535 |
| 2022 | 36,297 | 558 |
| 2023 | 37,703 | 582 |
| 2024 | 40,187 | 607 |
| 2025–2029 | 239,990 | 3,527 |

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 \$11,557 in 2019.

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, 2019. 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 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.

SHRINERS HOSPITALS FOR CHILDREN

Notes to Combined Financial Statements

December 31, 2019

(In thousands)

(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

SHRINERS HOSPITALS FOR CHILDREN

Notes to Combined Financial Statements

December 31, 2019

(In thousands)

annually to maintain the purchasing power of the endowment assets, as well as, to provide additional real growth through new gifts and investment return.

Endowment asset composition by type of fund, as of December 31, 2019, is as follows:

| | <u>Without donor restrictions</u> | <u>With donor restrictions</u> | <u>Total endowment assets</u> |
|-------------------------------------|---------------------------------------|------------------------------------|---------------------------------------|
| 2019: | | | |
| Board-designated endowment funds | \$ 8,147,085 | — | 8,147,085 |
| Donor-restricted endowment funds | <u>—</u> | <u>564,808</u> | <u>564,808</u> |
| | <u>\$ 8,147,085</u> | <u>564,808</u> | <u>8,711,893</u> |

Changes in endowment assets for the year ended December 31, 2019 are as follows:

| | <u>Without donor restrictions</u> | <u>With donor restrictions</u> | <u>Total endowment net assets</u> |
|----------------------------|---------------------------------------|------------------------------------|---|
| 2019: | | | |
| Balance, beginning of year | \$ 7,258,261 | 509,442 | 7,767,703 |
| Donations and bequests | | | — |
| Investment income | 215,899 | — | 215,899 |
| Net depreciation | 1,026,214 | 68,762 | 1,094,976 |
| Reclassifications | 13,396 | (13,396) | — |
| Withdrawals | <u>(366,685)</u> | <u>—</u> | <u>(366,685)</u> |
| Balance, end of year | <u>\$ 8,147,085</u> | <u>564,808</u> | <u>8,711,893</u> |

(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.

SHRINERS HOSPITALS FOR CHILDREN

Notes to Combined Financial Statements

December 31, 2019

(In thousands)

Expenses related to providing these services for the year ended December 31, 2019 are reflected in the table below (in thousands).

| | Year ended December 31, 2019 | | | | |
|---------------------------------|-------------------------------------|-----------------------------|---|--------------------------------|----------------|
| | Hospital expense | Research expense | Management and general expense | Fundraising expense | Total |
| Advertising and promotion | \$ 2,417 | 15 | 502 | — | 2,934 |
| Benefits | 63,596 | 1,152 | 14,861 | — | 79,609 |
| Contributions | — | 9 | — | — | 9 |
| Depreciation | 57,458 | — | 4,052 | — | 61,510 |
| Dues and registrations | 2,400 | 185 | 409 | 14 | 3,008 |
| Food supplies | 539 | 43 | — | — | 582 |
| Insurance | 6,509 | — | 298 | — | 6,807 |
| Medical supplies | 89,627 | 2,799 | — | — | 92,426 |
| Miscellaneous | 2,967 | 213 | 3,950 | 125 | 7,255 |
| Occupancy | 29,995 | 496 | 4,309 | 5 | 34,805 |
| Office expense | 3,079 | 239 | 21,306 | 32 | 24,656 |
| Other fees for service | 81,738 | 15,598 | 46,556 | 61,245 | 205,137 |
| Patient costs | 7,871 | 734 | 851 | — | 9,456 |
| Payroll taxes | 21,363 | — | 2,889 | — | 24,252 |
| Postage | 1,061 | 15 | 329 | 8,673 | 10,078 |
| PGA Event | — | — | — | 12,109 | 12,109 |
| Salaries | 336,121 | 8,511 | 39,043 | 3,412 | 387,087 |
| Travel | 4,459 | 420 | 2,551 | 286 | 7,716 |
| Total operating expenses | \$ 711,200 | 30,429 | 141,906 | 85,901 | 969,436 |

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.

SHRINERS HOSPITALS FOR CHILDREN

Notes to Combined Financial Statements

December 31, 2019

(In thousands)

(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 noncurrent investments. While not classified as a current asset, SHC has noncurrent 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, 2019 are as follows (in thousands):

| | | |
|---|----|-------------------------|
| Cash and cash equivalents | \$ | 40,980 |
| Receivables | | 62,774 |
| Short-term investments | | 141,184 |
| Noncurrent investments available within one year | | <u>7,628,377</u> |
| Total | \$ | <u><u>7,873,315</u></u> |

(15) Subsequent Events

SHC has evaluated events and transactions occurring subsequent to December 31, 2019 as of April 15, 2020, which is the date the combined financial statements were available to be issued. Subsequent to December 31, 2019, the COVID-19 Outbreak has caused much change to the economic circumstances of the United States, and Shriners Hospitals for Children. On March 11, 2020, the World Health Organization (WHO) declared COVID-19 as a pandemic. The impacts this has caused to Shriners Hospitals for Children is as follows:

- At December 31, 2019 our marketable securities were \$7,769,561, the low point subsequent to year end was on March 23, 2020, marketable securities dropped to their lowest level at \$6,100,000. As of April 15, 2020, marketable securities are \$6,800,000.
- In addition to the financial impact, as many jurisdictions have moved to a freeze on nonessential health procedures, many of our facilities have experienced significant volume decline. While we have not experienced the revenue impact of that yet, it will be forthcoming in the upcoming months.