Children’s National Medical Center and Subsidiaries

Consolidated Financial Statements and Supplementary Consolidating Information
June 30, 2019 and 2018

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Report of Independent Auditors

To the Board of Trustees of
Children's National Medical Center

We have audited the accompanying consolidated financial statements of Children's National Medical Center and its subsidiaries ("Children's National"), which comprise the consolidated balance sheets as of June 30, 2019 and 2018, and the related consolidated statements of operations, changes in net assets and cash flows for the years then ended.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on the consolidated financial statements based on our audits. We conducted our audits 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to Children's National's preparation and fair presentation of the consolidated 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 Children's National'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 consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Children's National Medical Center and its subsidiaries as of June 30, 2019 and 2018, and the results of their operations, their changes in net assets and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Notes 3 and 4 to the consolidated financial statements, Children's National changed the manner in which it presents net assets and reports certain aspects of its financial statements as a not-for-profit entity and the manner in which it accounts for revenue from contracts with customers in 2019. Our opinion is not modified with respect to this matter.

PricewaterhouseCoopers LLP

McLean, VA
October 4, 2019

Children’s National Medical Center and Subsidiaries
Consolidated Balance Sheets
June 30, 2019 and 2018

(in thousands)	2019	2018
Assets		
Current assets		
Cash and cash equivalents	$ 71,929	$ 111,213
Short term Investments	30,197	-
Short term assets whose use is limited by terms of debt agreement	19,694	-
Accounts receivable, net	195,047	180,494
Settlements due from third-party payors	7,714	7,506
Contributions receivable, net	56,895	60,940
Grant receivable	16,945	22,191
Inventories of supplies	11,964	13,355
Prepaid expenses and other	36,958	29,162
Total current assets	447,343	424,861
Noncurrent assets		
Property and equipment, net	612,565	565,922
Assets whose use is limited by professional liability claims	30,860	23,735
Investments	766,054	746,962
Contributions receivable, net	46,206	59,873
Loan receivable	13,496	-
Interest in beneficial trusts	8,055	8,357
Other	34,619	29,653
Total noncurrent assets	1,511,855	1,434,502
Total assets	$ 1,959,198	$ 1,859,363

The accompanying notes are an integral part of these consolidated financial statements.

Children’s National Medical Center and Subsidiaries
Consolidated Balance Sheets (continued)
June 30, 2019 and 2018

(in thousands)	2019	2018
Liabilities and Net Assets		
Current liabilities		
Accounts payable	$ 48,435	$ 38,351
Accrued salaries and other expenses	126,574	118,733
Current portion of reserve for claims	24,710	22,929
Settlements due to third-party payors	1,226	1,255
Deferred revenue	26,427	26,895
Current portion of long-term debt	5,879	5,911
Current portion of capital lease obligations	1,130	694
Total current liabilities	234,381	214,768
Noncurrent liabilities		
Long-term debt	498,332	460,653
Long-term capital lease obligations	24,532	5,058
Reserve for claims	68,955	65,676
Interest rate swaps	2	19,116
Other long-term liabilities	37,213	40,415
Total noncurrent liabilities	629,034	590,918
Total liabilities	863,415	805,686
Net Assets		
Without donor restrictions - attributable to Children's National	748,234	707,500
Without donor restrictions - noncontrolling interests	7,592	-
Total net assets without donor restrictions	755,826	707,500
With donor restrictions	339,957	346,177
Total net assets	1,095,783	1,053,677
Total liabilities and net assets	$ 1,959,198	$ 1,859,363

The accompanying notes are an integral part of these consolidated financial statements.

Children’s National Medical Center and Subsidiaries
Consolidated Statements of Operations
Years Ended June 30, 2019 and 2018

(in thousands)	2019	2018
Operating revenue and other support		
Net patient service revenue	$ 1,090,598	$ 1,049,578
Grant revenue	87,310	83,339
Other operating revenue	65,376	50,260
Contributions	24,645	32,045
Net assets released from restrictions used for operations	42,876	31,645
Total operating revenue and other support	1,310,805	1,246,867
Expenses		
Salaries, wages, and benefits	813,124	759,596
Supplies and other	348,488	324,735
Depreciation and amortization	65,100	58,758
Provision for insurance	15,192	11,688
Interest and amortization	18,728	17,161
Development expense	27,016	26,160
Total expenses	1,287,648	1,198,098
Operating income	23,157	48,769
Non-operating revenues and expenses		
Investment return, net	19,664	5,961
Realized and change in unrealized fair value of interest rate swaps	(7,626)	4,502
Other non-operating income (loss), net	(890)	2,193
Total non-operating revenues and expenses	11,148	12,656
Excess of revenues over expenses	34,305	61,425
Unrealized gain on investments	7,398	12,822
Property contribution	-	425
Contributions from noncontrolling interests	7,592	-
Released from restriction for property and equipment	1,508	3,054
Other changes in net assets without donor restrictions	(2,477)	-
Increase in net assets without donor restrictions	$ 48,326	$ 77,726

The accompanying notes are an integral part of these consolidated financial statements.

Children's National Medical Center and Subsidiaries
Consolidated Statements of Changes in Net Assets
Years Ended June 30, 2019 and 2018

(in thousands)	2019	2018
Net assets without donor restrictions		
Excess of revenues over expenses	$ 34,305	$ 61,425
Unrealized gain on investments	7,398	12,822
Property contribution	-	425
Contributions from noncontrolling interests	7,592	-
Released from restriction for property and equipment	1,508	3,054
Other changes in net assets without donor restrictions	(2,477)	-
Increase in net assets without donor restrictions	48,326	77,726
Net assets with donor restrictions		
Contributions	38,130	72,880
Investment return, net	11,046	14,840
Released from restrictions	(44,384)	(34,699)
Change in value of split interest agreements	(301)	173
Loss from uncollectible pledges	(13,193)	-
Other changes in net assets with donor restrictions	2,482	80
(Decrease) increase in net assets with donor restrictions	(6,220)	53,274
Change in net assets	42,106	131,000
Net assets		
Beginning of year	1,053,677	922,677
End of year	$ 1,095,783	$ 1,053,677

The accompanying notes are an integral part of these consolidated financial statements.

Children's National Medical Center and Subsidiaries
Consolidated Statements of Cash Flows
Years Ended June 30, 2019 and 2018

(in thousands)	2019	2018
Cash flows from operating activities		
Change in net assets	$ 42,106	$ 131,000
Adjustments to reconcile change in net assets to net cash and cash equivalents provided by operating activities		
Depreciation and amortization	65,100	58,758
Provision for uncollectible contributions	12,950	2,706
Loss (gain) on sale of assets	890	(2,193)
Amortization of deferred financing costs	185	185
Amortization of bond premium	(2,621)	(2,666)
Loss in PSV equity investment	9,942	10,549
Net realized and change in unrealized gains on investments	(22,779)	(25,618)
Change in fair market value of interest rate swaps	5,050	(8,093)
Contributions from noncontrolling interests	(7,592)	-
Proceeds from restricted contributions and income received	(6,814)	(6,557)
Change in assets and liabilities		
Accounts receivable for patient services	(14,553)	(1,100)
Settlements due from third-party payors	(208)	(204)
Other current assets and inventory of supplies	(6,405)	(6,604)
Contributions and grants receivable	10,008	(57,306)
Interest in beneficial trusts	302	(173)
Other noncurrent assets	(4,966)	(2,875)
Accounts payable	10,084	721
Accrued salaries and other expenses	5,791	4,946
Reserve for claims	5,060	(1,054)
Deferred revenue	(468)	604
Settlements due to third-party payors	(29)	(1,673)
Other noncurrent liabilities	(3,202)	(3,232)
Net cash and cash equivalents provided by operating activities	97,831	90,121
Cash flows from investing activities		
Purchases of property, plant and equipment	(91,339)	(72,555)
Proceeds from sales of property, plant and equipment	1,000	4,509
Loan paid to Children's National NMTC Investment Fund, LLC	(13,496)	-
Settlement of interest rate swap	(24,164)	-
Purchases of investments	(275,949)	(199,816)
Sales of investments	240,251	157,637
Contribution to equity investment	(7,879)	(10,494)
Net cash and cash equivalents used in investing activities	(171,576)	(120,719)
Cash flows from financing activities		
Proceeds from issuance of long-term debt	25,000	-
Payments of long-term debt	(3,290)	(3,265)
Payments of debt issuance costs	(1,321)	-
Contributions from noncontrolling interests	7,592	-
Proceeds from restricted contributions and income received	6,814	6,557
Payments on capital lease obligations	(334)	(331)
Net cash and cash equivalents provided by financing activities	34,461	2,961
Decrease in cash and cash equivalents	(39,284)	(27,637)
Cash and cash equivalents		
Beginning of year	111,213	138,850
End of year	$ 71,929	$ 111,213
Supplemental disclosure of cash flow information		
Cash paid for interest	$ 22,108	$ 23,662
Capital lease obligations for new property and equipment	(20,244)	-
Property, plant and equipment in accounts payable	6,958	4,908

The accompanying notes are an integral part of these consolidated financial statements.

1. Organization

The Children's National Medical Center's ("Children's National") consolidated financial statements include the accounts of Children's Hospital (the "Hospital"); Children's Hospital Foundation (the "Foundation"); Children's National at Walter Reed, LLC ("CNWR"); Children's Research Institute ("CRI"); Safe Kids Worldwide ("Safe Kids"); Children's Pediatricians and Associates ("CP&A"); Children's National Health Network ("CNHN"); Pediatric Health Network ("PHN"); Children's National Advocacy and Public Policy, Inc. ("CNAPPI"); Children's School Services ("CSS"); Brainy Camps Association ("BCA"); Bearacuda Reinsurance Company, Ltd. (the "Captive"); Building 52/53 NMTC Borrower LLC; Building 52/53 HTC Tenant LLC; Building 52/53 Managing Member LLC; Building 54 NMTC Borrower LLC; Building 54 HTC Tenant LLC; Building 54 Managing Member LLC; all referred to as the "Subsidiaries."

Children's National is a tax-exempt, nonstock corporation, which controls its subsidiary corporations through its authority to appoint the governing boards of the tax-exempt, nonstock subsidiaries or its stock ownership. Children's National and its subsidiaries provide health care services to infants, children, and youth in Washington, D.C., and the surrounding metropolitan area. The Hospital operates an acute care pediatric and teaching facility.

The Foundation supports and maintains the programs, services, and facilities of Children's National in part through solicitation, receipt, administration, and distribution of philanthropic gifts on behalf of its tax-exempt subsidiaries.

CNWR is a limited liability company organized for the purpose of holding certain real property conveyed by the United States Department of Defense to be used for public health purposes.

CRI is a research organization involved in providing services and support in connection with the delivery of health care services on behalf of the community.

Safe Kids is an organization involved in nonhospital pediatric health and safety activities.

CP&A is a limited liability corporation that operates for-profit physician practices. CP&A is owned 50% by Children's National and 50% by the Hospital.

CNHN is a for-profit physician hospital organization, of which Children's National is the sole shareholder.

PHN is a for-profit clinically integrated physician network, of which Children's National is the sole shareholder.

CNAPPI is an organization involved in addressing the advocacy mission and community benefit activities of Children's National. CNAPPI was dissolved effective June 30, 2019.

CSS is an organization that operates a school nurse program in the District of Columbia.

BCA is an organization that provides residential summer camps, support, and leadership programs for youth with chronic health conditions, of which the Hospital is the sole corporate member.

The Captive is a wholly owned captive insurance company established to assume general liability and malpractice risk for Children's National entities, effective August 1, 1997.

Building 52/53 NMTC Borrower LLC ("Building 52/53 Borrower"), a Washington, D.C., limited liability company, was formed to acquire, own, rehabilitate, lease, manage, and operate the property known as Building 52/53 in a manner that will qualify such rehabilitation for historic and new market rehabilitation tax credits to Section 47 of the Internal Revenue Code of 1986, as amended. The property is comprised of land and historic buildings located on the former campus of the Walter Reed Army Medical Center in Washington D.C. (the "WR Campus"). Building 52/53 is also located in a qualified census tract that meets certain income, unemployment and poverty level requirements and qualifies under the New Market Tax Credit Program as a qualified active low-income community business ("QALICB"). Through its ownership of Building 52/53 Managing Member LLC, CNMC holds a 90% interest in Building 52/53 Borrower. Building 52/53 Borrower follows a calendar based fiscal year.

Building 52/53 Managing Member LLC ("Building 52/53 MM"), a Washington D.C., limited liability company, is the managing member of Building 52/53 Borrower. Building 52/53 MM is a wholly owned subsidiary of Children's National, and is taxed as a corporation. The member managers of Building 52/53 MM are officers and senior leaders of Children's National. As part of the New Market Tax Credit and Historic Tax Credit transactions, this separate, for-profit, single purpose entity was established to manage the Building 52/53 property to meet the QALICB requirements. Building 52/53 MM is the manager of the property and also the managing member of Building 52/53 HTC Tenant LLC, holding a 1% interest in Building 52/53 HTC Tenant LLC. Building 52/53 MM follows a calendar based fiscal year.

Building 52/53 HTC Tenant LLC ("Building 52/53 Tenant"), a Washington, D.C., limited liability company, was formed to lease, manage and operate property owned by Building 52/53 Borrower. Building 52/53 Tenant has made an equity investment in Building 52/53 Borrower and is also a member with a 10% interest. Building 52/53 Tenant consists of a managing member with 1% interest and an investor member with a 99% interest. Building 52/53 Tenant and Building 52/53 Borrower have executed a historic tax credit pass-through agreement pursuant to which Building 52/53 Borrower will elect under Section 50 of the Internal Revenue Code to pass through to Building 52/53 Tenant the federal tax credits to which it is entitled because of the historic buildings rehabilitation project. Children's National meets the requirements for consolidation of the Building 52/53 Tenant through its ownership of the managing member (Building 52/53 MM) and control of Building 52/53 Tenant. The 99% interest held by an investor member is reflected as non-controlling interest. Building 52/53 Tenant follows a calendar based fiscal year.

Building 54 NMTC Borrower LLC ("Building 54 Borrower"), a Washington, D.C., limited liability company, was formed to acquire, own, rehabilitate, lease, manage, and operate the property known as Building 54 in a manner that will qualify such rehabilitation for historic rehabilitation tax credits pursuant to Section 47 of the Internal Revenue Code of 1986, as amended. The property is comprised of land and a historic building located on the WR Campus. Through its ownership of Building 54 Managing Member LLC, CNMC holds a 90% interest in Building 54 Borrower. Building 54 Borrower follows a calendar based fiscal year.

Building 54 Managing Member LLC ("Building 54 MM"), a Washington D.C., limited liability company, is the managing member of Building 54 Borrower. Building 54 MM is a wholly owned subsidiary of Children's National and is taxed as a corporation. The member managers of Building 54 MM are officers and senior leaders of Children's National. Building 54 MM is the manager of the property and also the managing member of Building 54 HTC Tenant LLC, holding a 1% interest in Building 54 HTC Tenant LLC. Building 54 MM follows a calendar based fiscal year.

Building 54 HTC Tenant LLC ("Building 54 Tenant"), a Washington, D.C., limited liability company, was formed to lease, manage and operate property owned by Building 54 Borrower. Building 54 Tenant has made an equity investment in Building 54 Borrower and is also a member with a 10% interest. Building 54 Tenant consists of a managing member with 1% interest and an investor member with a 99% interest. Building 54 Tenant and Building 54 Borrower have executed a historic tax credit pass-through agreement pursuant to which Building 54 Borrower will elect under Section 50 of the Internal Revenue Code to pass through to Building 54 Tenant the federal tax credits to which it is entitled because of the historic buildings rehabilitation project. Children's National meets the requirements for consolidation of the Building 54 Tenant through its ownership of the managing member (Building 54 MM) and control of Building 54 Tenant. The 99% interest held by an investor member is reflected as non-controlling interest. Building 54 Tenant follows a calendar based fiscal year.

Children's National, Hospital, Foundation, CRI, Safe Kids, CNAPPI, CSS, and BCA are not-for-profit organizations that qualify under Section 501(c)(3) of the Internal Revenue Code, and are therefore, not subject to tax under current income tax regulations.

2. Risk Factors

Children's National's ability to maintain or increase future revenues could be adversely impacted by: (1) future legislation, regulation, or other actions by federal, state, or District of Columbia agencies, which may impose requirements or continue the trend toward more restrictive limitations on reimbursement for hospital services; (2) future legislation or adverse trends affecting the costs related to professional liability coverage; (3) changes in general and local economic conditions including the financial condition of the District of Columbia, the State of Maryland and the State of Virginia; and (4) a potential shortage of qualified doctors and other skilled healthcare professionals in the local employment market.

3. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying consolidated financial statements have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America.

Principles of Consolidation

The consolidated financial statements include the accounts of Children's National and all its subsidiaries after elimination of all significant intercompany accounts and transactions.

Cash and Cash Equivalents

Cash equivalents include amounts invested in accounts with depository institutions which are readily convertible to cash, with original maturities of three months or less. Total deposits maintained at these institutions at times exceed the amount insured by federal agencies and therefore, bear a risk of loss. Children's National has not experienced such losses on these funds.

Investments and Assets Whose Use is Limited

Children's National classifies investments as available for sale. Investments consist primarily of money market funds, government securities, equity securities (including common trust funds), and mutual funds that are considered other than trading securities and are reported at fair value. Investments that management does not consider necessary for current operations are classified as long-term.

Investments in companies in which Children's National does not have control, but has the ability to exercise significant influence over operating and financial policies are accounted for under the equity method of accounting and operating results are recorded within investment return, net on the Consolidated Statements of Operations. Dividends received are recorded as a reduction of the carrying amount of the investment.

Assets whose use is limited include resources restricted under professional liability arrangements and debt agreements.

Investment Income

Investment income or loss (including interest and dividends, net of investment management fees; realized gains and losses on investments; and any provision for other-than-temporary losses on impairment of investments) is reported as non-operating revenue and is included in excess of revenue over expenses unless the income or loss is restricted by donor or law. Unrealized gains and losses on investments, if any, are excluded from excess of revenues over expenses, unless the losses are deemed to be other-than-temporary.

Children's National periodically evaluates whether any declines in the fair value of investments are other-than-temporary. This evaluation consists of a review of several factors, including, but not limited to: length of time and extent that a security has been in an unrealized loss position, the existence of an event that would impair the issuer's future earnings potential, the near-term prospects for recovery of the market value of a security, and the intent and ability of Children's National to hold the security until the market value recovers. Declines in fair value below cost that are deemed to be other-than-temporary losses are included in non-operating revenues and expenses in the accompanying Consolidated Statements of Operations. Investments are principally uninsured and subject to normal credit risk.

Income Taxes

Children's National is a not-for-profit corporation as described in Section 501(c)(3) of the Internal Revenue Code and is exempt from federal income taxes on related income pursuant to Section 501(a) of the Code. On such basis, the exempt entities will not incur any liability for federal income taxes, except for possible unrelated business income.

The Financial Accounting Standards Board's ("FASB") guidance on accounting for uncertainty in income taxes clarifies the accounting for uncertainty of income tax positions. The guidance defines the threshold for recognizing tax return positions in the consolidated financial statements as "more likely than not" that the position is sustainable, based on technical merits.

Children's National evaluates uncertain tax positions using a two-step approach for recognizing and measuring tax benefits taken or expected to be taken in an unrelated business activity tax return and disclosures regarding uncertainties in tax positions. There was no impact on Children's National's consolidated financial statements during the years ended June 30, 2019 and 2018, as Children's National has no uncertain tax positions.

Accounts Receivable, net

Patient accounts receivable consist primarily of amounts owed by various governmental agencies, insurance companies and patients. Children's National manages these receivables by regularly reviewing the accounts and contracts and by recording appropriate price concessions. Children's National reports accounts receivable at an amount equal to the consideration it expects to receive in exchange for providing healthcare services to its patients, which is estimated using contractual provisions associated with specific payors, historical reimbursement rates and analysis of past experience to estimate potential adjustments. Children's National writes off amounts that have been deemed to be uncollectible because of circumstances that affect the ability of payors to make payments as they occur.

Inventories of Supplies

Inventories generally consist of medical and nonmedical supplies, and are stated at the lower of cost or market, using the first-in, first-out method. The total inventory balance was $12.0 million and $13.4 million at June 30, 2019 and 2018, respectively.

Contributions and Grants

Unconditional promises to give cash and other assets are reported at fair value as contributions receivable at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the promise becomes unconditional. As of June 30, 2019 and 2018, conditional promises to give excluding those from grants, amounted to $4.5 million. These promises are subject to annual donor approval and are restricted. Amounts due are recorded at the net realizable value discounted using a rate of return that a market participant would expect to receive over the payment period at the date the pledge is received. An allowance for uncollectible pledges is recorded for pledges which may become uncollectible in future periods. Amounts deemed to be uncollectible have been written off. The contributions receivable balance is based on management's best estimate of the amounts expected to be collected. The amounts Children's National will ultimately realize could differ from the amounts assumed in arriving at the present value and allowance for doubtful pledges.

The gifts are reported as net assets with donor restrictions if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is met, net assets with donor restrictions are reclassified as net assets without donor restrictions and reported in the Consolidated Statements of Operations as net assets released from restrictions used for operations. Donor-restricted contributions whose restrictions are met within the same year as received are reported as net assets without donor restrictions in the accompanying consolidated financial statements.

Children's National and its subsidiaries receive various grants from Federal agencies and District of Columbia agencies for the purpose of furthering its mission of providing acute pediatric care, research and education. For the majority if its grants, Children's National accounts for them under the contribution model, which is outside the scope of ASC 606, *Revenue from Contracts with Customers.* Revenue for these grants is recognized as expenses are incurred.

Total conditional contributions from grants as of June 30, 2019 were $58.8 million. Revenue for these conditional contributions will be recognized in future periods when the conditions are met. The conditions related to these contributions are based on performance barriers, a right of return, and scope related conditions as outlined under the Uniform Guidance cost principles. Children's National has elected the simultaneous release option which allows a conditional restricted contribution to be recognized directly in net assets without donor restrictions if the condition and restriction is met in the same period that the revenue is recognized.

In June 2018, the FASB issued ASU 2018-08, *Not-for-Profit Entities (Topic 958), Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*. The new standard applies to all entities that receive or make contributions. The guidance clarifies the definition of transactions accounted for as an exchange transaction subject to ASU 2014-09 or other applicable guidance and transactions that should be accounted for as contributions (non-exchange) subject to the contribution accounting model. Further, the guidance provides criteria for evaluating whether contributions are unconditional or conditional. Conditional contributions must specify a barrier that the recipient must overcome and a right of return that releases the donor from its obligation if the barrier is not achieved, otherwise the contribution is unconditional. Children's National adopted this guidance in 2019 and there were no significant impacts to revenue recognition.

Loan Receivable

As part of the New Market Tax Credit and Historic Tax Credit transactions, Children's Hospital made a leveraged loan to Children's National NMTC Investment Fund, LLC in the amount of $13.5 million on June 20, 2019. The loan bears interest at 1.3% with quarterly interest only payments due September 2019 through March 2026, followed by quarterly principal and interest payments of $160 thousand through June 2049.

New Accounting Pronouncements

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments-Overall: Recognition and Measurement of Financial Assets and Financials Liabilities.* ASU 2016-01 addresses accounting for equity investments, financial liabilities under the fair value option, and the presentation and disclosure requirements for financial instruments. Entities that are not considered public business entities will no longer be required to disclose the fair value of financial instruments carried at amortized cost. The amendments in ASU 2016-01 are effective for years beginning after December 15, 2018, and early adoption is permitted. Children's National early adopted the provisions of this standard for the fiscal year ended June 30, 2016 that no longer requires disclosure of the fair value of financial instruments carried at amortized cost. Effective for fiscal year 2020, unrealized gains and losses on investments will be classified above excess of revenues over expenses within Investment Return, net.

In February 2016, the FASB issued ASU 2016-02, *Leases* and has subsequently issued supplemental and/or clarifying ASUs (collectively "ASC 842"). ASU 842 will require entities that lease assets—referred to as the "lessee"—to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases. The liability will be equal to the present value of future minimum lease payments. The asset will be based on the liability, subject to adjustment for certain costs. The recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee will depend on its classification as a finance or an operating lease. The accounting by entities that own the assets leased by the lessee—referred to as the lessor will remain largely unchanged. Children's National plans to elect the package of practical expedients permitted by the standard, which among other things, allows an entity to not reassess, at adoption, its prior conclusions on whether an existing contract contains a lease, lease classification for existing leases, and whether costs incurred for existing leases qualify as initial direct costs. Children's National also plans to elect the practical expedient under ASU 2018-11 that allows lessees to choose not to separate lease and non-lease components by lease classification. The new standard was effective for Childrens National on July 1, 2019. While Children's National continues to assess the effect of adoption, the standard will result in recognition of significant lease assets and lease liabilities; however, this guidance is not expected to materially affect our operating results or cash flows.

In August 2016, the FASB issued ASU 2016-14, *Presentation of Financial Statements for Not-for-Profit Entities*. The new guidance is intended to improve the net asset classification requirements and the information presented in the financial statements and notes about a not-for profit entity's liquidity, financial performance, and cash flows. Main provisions of this guidance include: presentation of two classes of net assets versus the previously required three classes of net assets and recognition of underwater endowment funds as a reduction in net assets with donor restrictions. The guidance also enhances disclosures for board designated amounts, composition of net assets without donor restrictions, liquidity, and expenses by both their natural and functional classification. Children's National adopted this guidance in 2019.

The net asset reclassifications due to the adoption of ASU 2016-14 as of June 30, 2018 are as follows:

(in thousands)	ASU 2016-14 Classifications		
Net Assets Classifications	**Without donor restrictions**	**With donor restrictions**	**Total Net Assets**
As previously presented:			
Unrestricted	$ 707,500	$ -	$ 707,500
Temporarily restricted	-	199,281	199,281
Permanently restricted	-	146,896	146,896
Net assets	$ 707,500	$ 346,177	$ 1,053,677

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*, which adds or clarifies guidance on the classification of certain cash receipts and payments in the statement of cash flows with the intent to alleviate diversity in practice. The update is effective for fiscal years beginning after December 15, 2018, with early adoption permitted. Children's National is currently evaluating the impact of this update on the Consolidated Statements of Cash Flows beginning in fiscal year 2020.

In November 2016, the FASB issued ASU 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash*, which clarifies the classification and presentation of changes in restricted cash in the statement of cash flows. The guidance requires reporting entities to explain the changes in the consolidated total of restricted and unrestricted cash and cash equivalent balances in the statement of cash flows. The update is effective for fiscal years beginning after December 15, 2018, with early adoption permitted. Children's National is currently evaluating the impact of this update on the Consolidated Statements of Cash Flows beginning in fiscal year 2020.

In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework-Changes to the Disclosure Requirements for Fair Value Measurement*. ASU 2018-13 is intended to improve the effectiveness of disclosure requirements on fair value measurement. Amongst other changes, ASU 2018-13 removes: i) the requirement to disclose the amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy, ii) the requirement to disclose the policy for timing of transfers between levels, iii) disclosure of the valuation processes for Level 3 fair value measurements, and iv) the requirement for nonpublic entities to disclose the changes in unrealized gains and losses included in earnings for recurring Level 3 fair value measurements held at the end of the reporting period. In addition, ASU 2018-13 modifies the disclosure requirements to: i) allow nonpublic companies to disclose transfers into and out of Level 3 of the fair value hierarchy and purchases and issues of Level 3 assets and liabilities as an alternative to reconciling the opening balances to the closing balances of recurring Level 3 fair value measurements, and ii) require disclosure for investments in certain entities that calculated net asset value of the timing of liquidation of an investee's assets and the date redemption might lapse only if the investee has communicated the timing to the entity or announced the timing publicly. The update is effective for fiscal years, and interim periods with those fiscal years, beginning after December 15, 2019 with early adoption permitted. An entity is permitted to early adopt any removed or modified disclosures upon the issuance of ASU 2018-13 and delay adoption of the additional disclosures until their effective date. Children's National is evaluating the impact of this update on the consolidated financial statements beginning in fiscal year 2021.

Property and Equipment

Property and equipment acquisitions are recorded at cost. Depreciation expense on Children's National's property and equipment is recorded using the straight-line method, which allocates the cost of the tangible property equally over the estimated useful lives, beginning with the date the asset is placed in service. Below are the uselife lives by asset category:

Buildings	30 - 40 years
Building improvements	9 - 20 years
Fixed equipment	10 - 15 years
Movable equipment	3 - 20 years

Equipment under capital lease obligations is amortized on the straight-line method over the shorter period of the lease term or the estimated useful life of the asset. Such amortization is included in depreciation and amortization in the Consolidated Statements of Operations. Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets, net of any income earned. Repairs and maintenance are expensed as incurred. When property and equipment are retired, sold or otherwise disposed of, the asset's carrying amount and related accumulated depreciation are removed from the accounts and any gain or loss is included in non-operating revenues and expenses.

Deferred Financing Costs

Financing costs incurred in connection with the issuance of long-term debt are deferred and amortized using the straight-line method, which approximates the effective interest rate method, over the period of time the debt is outstanding. Deferred financing costs are recorded in long-term debt on the Consolidated Balance Sheets. The amortization expense was approximately $185.1 thousand and $185.4 thousand for the years ended June 30, 2019 and 2018, respectively.

Impairment of Long-Lived Assets

Long-lived assets are reviewed for impairment when events and circumstances indicate that the carrying amount of an asset may not be recoverable. Children's National's policy is to record an impairment loss when it is determined that the carrying amount of the asset exceeds the sum of the expected undiscounted future cash flows resulting from the use of the asset and its eventual disposition. Impairment losses are measured as the amount by which the carrying amount of the asset exceeds its fair value. Long-lived assets to be disposed of are reported at the lower of the carrying amount or fair value less cost to sell. There were no impairments of long-lived assets for the years ended June 30, 2019 and 2018.

Interest in Beneficial Trusts

Children's National also receives contributions in the form of irrevocable split-interest agreements. These agreements include charitable remainder trusts, charitable gift annuities and perpetual trusts. In all of these agreements, Children's National has an interest in the trust, but is not the trustee. When the trust's obligations to all beneficiaries expire, the remaining assets revert to Children's National to be used according to the donor's wishes.

Other Long-Term Liabilities
Children's National entered into a favorable cash deferral contact with Cerner, Inc. ("Cerner") related to expenses associated with the Bear Institute in September 2013. The Bear Institute is a purchased services information technology agreement where Cerner manages IT functionality for operational services and capital equipment acquisitions. As an incentive, the cash flows for the agreement are significantly deferred towards the latter portion of the seven-year agreement. The liability due to Cerner under this arrangement was $7.4 million and $12.2 million as of June 30, 2019 and 2018, respectively, and is recorded in other long-term liabilities.

Deferred Compensation Plan
Children's National maintains a deferred compensation plan for certain employees. As of June 30, 2019 and 2018, deferred compensation investments of $26.1 million and $22.1 million, respectively, included in other assets on the consolidated balance sheets, represent investments held by Children's National under these deferred compensation agreements. Such amounts approximate Children's National's related liability to the employees and are included in other long-term liabilities.

Interest Rate Swaps
The value of the interest rate swap agreements entered into by Children's National is adjusted to fair value monthly at the close of each accounting period based upon quotations from market makers. The change in fair value, if any, is recorded in the Consolidated Statements of Operations. Entering into interest rate swap agreements involves, to varying degrees, elements of credit, default, prepayment, market and documentation risk in excess of the amounts recognized on the Consolidated Balance Sheets. Such risks involve the possibility that there will be no liquid market for these agreements, the counterparty to these agreements may default on its obligation to perform and there may be unfavorable changes in interest rates.

Net Assets
Net assets without donor restrictions include undesignated amounts as well as amounts designated by the board for future capital and operating purposes. Net assets with donor restrictions are those whose use by Children's National has been limited by donors to a specific time period or purpose, including federal appropriations restricted for capital improvements. Net assets are released from donor restriction by incurring expenses satisfying the restricted purpose or by occurrence of the passage of time or other events specified by donors. Also included in net assets with donor restrictions are those gifts that have been restricted by donors to be maintained by Children's National in perpetuity. As of June 30, 2019 and 2018, $755.8 million and $707.5 million, respectively, of net assets without donor restrictions were available. The amount of board designated investments included within net assets, without donor restriction was $468.1 million and $466.7 million as of June 30, 2019 and 2018, respectively.

Charity Care
Children's National, in keeping with its mission and philosophy to extend quality care and compassionate service, recognizes that some patients are unable to compensate Children's National for their treatment either through third party coverage or their own resources. Accordingly, Children's National extends charity or free care to those patients who do not have the ability to meet their obligations. Children's National provides free care based on federal poverty income guidelines or when it is determined that the patients are unable to fulfill their obligations to Children's National. Children's National also provides assistance in helping patients obtain third party coverage through state Medicaid programs. Because Children's National does not pursue collections of amounts determined to qualify as charity care, they are not reported as revenue. Direct and indirect costs for these services amounted to $8.7 million and $5.8 million for the years

ended June 30, 2019 and 2018, respectively. The costs of providing charity care services are based on a calculation which applies a ratio of costs to charges to the gross uncompensated charges associated with providing care to charity patients. The ratio of cost to charge is calculated based on Children's National's total operating expenses divided by patient service revenue.

In addition to direct charity care, Children's National is committed to improving the health and well-being of children in the Washington, D.C., metropolitan area. Through programs of clinical intervention, community awareness, education and advocacy, Children's National strives to address the many challenges facing children and families today. Examples of programs addressing these challenges are the Community Pediatric Health Care Centers, school nursing services for District of Columbia Public Schools and District of Columbia Public Chartered Schools, Team Kid Power (KIPOW), DC Collaborative for Mental Health in Pediatric Primary Care, Health Access in Pediatrics (DC MAP) Program, and services provided to children with AIDS.

Excess of Revenues Over Expenses

The Consolidated Statements of Operations include excess of revenues over expenses. Changes in net assets without donor restrictions which are excluded from excess of revenues over expenses, consistent with industry practice, include, among other items, the change in unrealized gains or losses on investments other than trading securities and contributions released from restrictions for property and equipment.

Use of Estimates

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during reporting period. Actual results could differ from these estimates. These significant estimates include, among others, estimated net realizable value of patient receivables, estimated third-party payor settlements, and accrued insurance costs.

Accrued Vacation

Children's National records a liability for amounts due to employees for future absences which are attributable to services performed in the current and prior period. The liability for accrued vacation was $32.6 million and $30.9 million as of June 30, 2019 and 2018, respectively, and is recorded in accrued salaries and other expenses.

Estimated Malpractice Costs

The provision for estimated medical malpractice claims includes estimates of the ultimate costs for both reported claims and claims incurred but not reported.

Medical Claims Reserve

Children's National's medical claims reserve is an estimate of payments to be made for claims losses incurred but not reported. The estimate was developed using actuarial methods based upon historical data for payment patterns, cost trends, and other relevant factors. The estimate is continually reviewed and adjusted as necessary as experience develops or new information becomes known, such adjustments are included in current operations.

4. Revenue Recognition

Beginning in May 2014, the FASB issued several Accounting Standards Updates which established Topic 606, *Revenue from Contracts with Customers* (the "standard"). This standard supersedes existing revenue recognition requirements and seeks to eliminate most industry-specific guidance under current GAAP. The core principle of the new guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services.

Children's National adopted this standard on July 1, 2018, using the full retrospective transition method. Adoption of the standard impacted Children's National's reported results as follows:

(in thousands)	June 30, 2018		
	As Reported	**As Adjusted**	**Total Adoption Impact**
Consolidated Statement of Operations and Changes in Net Assets			
Net patient services revenue	$ 1,079,327	$ 1,049,578	$ 29,749
Provision for uncollectible accounts	(29,749)	-	(29,749)
Consolidated Statement of Cash Flows			
Provision for uncollectible accounts	29,749	-	29,749
Change in accounts receivable	(30,849)	(1,100)	(29,749)

Adoption of this standard had no impact on Children's National's fiscal year 2018 opening net assets. This standard requires new disclosures about the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. The applicable disclosures are included in this footnote.

Net Patient Service Revenue

Net patient service revenue is reported at the amount that reflects the consideration to which Children's National expects to be entitled in exchange for providing patient care. These amounts are due from patients, third-party payors (including health insurers and government programs), and others. Generally, Children's National bills the patient and third-party payors several days after the services are performed and/or the patient is discharged from the facility. Revenue is recognized as performance obligations are satisfied.

Performance obligations are determined based on the nature of the services provided by Children's National. Revenue for performance obligations satisfied over time is recognized based on actual charges incurred in relation to total expected or actual charges. Children's National believes that this method provides a faithful depiction of the transfer of services over the term of the performance obligation based on the inputs needed to satisfy the obligation. Generally, performance obligations satisfied over time relate to patients receiving inpatient acute care services. Children's National measures the performance obligation from admission into the hospital to the point when it is no longer required to provide services to that patient, which is generally at the time of discharge. Revenue for performance obligations satisfied at a point in time is recognized when goods or sevices are provided and Children's National does not believe it is required to provide additional goods or services to the patient.

Because all of its performance obligations relate to contracts with a duration of less than one year, Children's National has elected to apply the practical expedient provided in FASB ASC 606-10-50-14a, and therefore is not required to disclose the aggregate amounts of the transaction price allocated to performance obligations that are unsatisfied or partially unsatisfied at the end of the reporting period. These performance obligations are primarily related to inpatient acute care services at the end of the reporting period. The performance obligations for these contracts are generally completed when the patients are discharged, which generally occurs within days or weeks of the end of the reporting period.

Generally patients who are covered by third-party payors are responsible for related deductibles and coinsurance, which vary in amount. Children's National also provides services to uninsured patients. The transaction price for both uninsured patients, as well as insured patients with deductibles and coinsurance, is estimated based on historical experience and current market conditions. The initial estimate of the transaction price is determined by reducing the standard charge by any contractual adjustments, discounts and implicit price concessions. Children's National determines its estimates of contractual adjustments and discounts based on contractual agreements, its discount policies and historical experience. Children's National determines its estimate of implicit price concessions based on historical collection experience with these classes of patients using a portfolio approach as a practical expedient. The portfolio approach is being used as Children's National has a large volume of similar contracts with similar classes of customers. Management's judgment to group the contracts by portfolio is based on the payment behavior expected in each portfolio category. Children's National reasonably expects that the effect of applying a portfolio approach to a group of contracts would not differ materially from considering each contract separately.

Subsequent changes to the estimate of the transaction price are generally recorded as adjustments to patient service revenue in the period of change. No significant amounts of revenues were recognized in the current year due to changes in the estimates of implicit price concessions, discounts and contractual adjustments for performance obligations satisfied in the prior years. Subsequent changes that are determined to be the results of an adverse change in the patient's or third party payor's ability to pay are recorded as bad debt expense. Bad debt expense is reported as a component of supplies and other in the consolidated statements of operations and changes in net assets and was not significant for the years ended June 30, 2019 and 2018.

Children's National has agreements with third-party payors that provide for payments to Children's National at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed cost, discounted charges, and per diem payments. Contractual adjustments to patient service revenue were $1.51 billion and $1.43 billion for the years ended June 30, 2019 and 2018, respectively.

Approximately 47% and 49% of net patient service revenues were from Medicaid and Medicaid managed care programs in 2019 and 2018, respectively. Total reimbursements received for Graduate Medical Education ("GME") were $12.3 million in 2019 and $12.8 million in 2018. Federal GME is subject to appropriation each year.

Inpatient and outpatient services, defined capital and medical education costs related to beneficiaries are paid using a cost reimbursement methodology for Medicare and the Fee-for-Service Medicaid programs. These services are paid prospectively for DC Medicaid and Maryland Medicaid. For cost reimbursable items, Children's National is reimbursed at a tentative rate with final settlement determined after submission of the annual cost reports by Children's National and audits thereof by the fiscal intermediary. Children's National cost reports have been audited and settled by the Medicare intermediary through 2017 for all facilities. The Virginia Medicaid cost report is settled annually and is settled through 2018.

Laws and regulations concerning government programs, including Medicare and Medicaid, are complex and subject to interpretation. Compliance with such laws and regulations may also be subject to future government review and interpretation as well as significant regulatory action, including fines, penalties, and potential exclusion from the related programs. There can be no assurance that regulatory authorities will not challenge Children's National's compliance with these laws and regulations, and it is not possible to determine the impact (if any) such claims or penalties would have upon Children's National. In addition, the contracts Children's National has with commercial payors also provide for retroactive audit and review of claims.

Cost report settlements under reimbursement agreements with Medicare and Medicaid for retroactive adjustments due to audits, reviews or investigations are considered variable consideration and are included in the determination of the estimated transaction price for providing patient care. These settlements are estimated based on the terms of the payment agreement with the payor, correspondence from the payor and Children's National's historical experience. Estimated settlements are adjusted in future periods as final settlements are determined. There is a reasonable possibility that recorded estimates will change by a material amount in the near term. Adjustments arising from a change in the transaction price were not significant in 2019 and 2018.

The composition of net patient service revenues by payor for the years ended June 30, is as follows:

(in thousands)	**2019**	**2018**
Blue Cross	$ 244,839	$ 205,027
Commercial	8,617	5,474
Managed Care	293,377	288,861
Medicaid	511,295	518,524
Other	29,000	28,286
Self-pay	3,470	3,406
Total	$ 1,090,598	$ 1,049,578

Children's National has elected the practical expedient allowed under FASB ASC 606-10-32-18 and does not adjust the promised amount of consideration from patients and third-party payors for the effects of a significant financing component due to Children's National's expectation that the period between the time the service is provided to a patient and the time that the patient or a third-party payor pays for that service will be one year or less. However, Children's National does, in certain instances, enter into payment agreements with patients that allow payments in excess of one year. For those cases, the financing component is not deemed to be significant to the contract.

Other Revenue

In addition to net patient service revenue, Children's National also recognizes revenue related to other transactions. These transactions include revenues from parking, pharmacy 340b programs, collaborative arrangements with other healthcare providers, transport and PSV. Revenue from these transactions is recognized when obligations under the terms of the respective contract are satisfied. Revenue from these transactions is measured as the amount of consideration Children's National expects to receive from those services.

5. Fair Value Measurements

Children's National follows the FASB's guidance on fair value measurements, which defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, establishes a framework for measuring fair value, and expands disclosures about such fair value measurements. This guidance applies to other accounting pronouncements that require or permit fair value measurements, and accordingly, this guidance does not require any new fair value measurements. The guidance discusses valuation techniques such as the market approach, cost approach and income approach. This guidance establishes a three-tier level hierarchy for fair value measurements based upon the transparency of inputs used to value an asset or liability as of the measurement date.

The three-tier hierarchy prioritizes the inputs used in measuring fair value as follows:

Level 1 Observable inputs such as quoted market prices for identical assets or liabilities in active markets;

Level 2 Observable inputs for similar assets or liabilities in an active market, or other than quoted prices in an active market that are observable either directly or indirectly; and

Level 3 Unobservable inputs in which there is little or no market data that require the reporting entity to develop its own assumptions.

The financial instrument's categorization within the hierarchy is based upon the lowest level of input that is significant to the fair value measurement. Each of the financial instruments below has been valued utilizing the market approach.

The following tables present the financial instruments carried at fair value grouped by hierarchy level:

(in thousands)	June 30, 2019		
	Quoted In Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Total Fair Value
Assets			
Investments			
Cash and cash equivalents	$ 126,761	$ -	$ 126,761
Fixed income securities	233,763	44,829	278,592
Equity securities	411,571	25	411,596
Real estate investments	-	6,125	6,125
Total investments	772,095	50,979	823,074
Deferred compensation money market funds	1,853	-	1,853
Deferred compensation mutual funds	24,266	-	24,266
Beneficial interests held by 3rd party	-	816	816
Perpetual trusts held by 3rd party	-	7,239	7,239
Short term assets whose use is limited by terms of debt agreement	19,694	-	19,694
Total assets at fair value	$ 817,908	$ 59,034	$ 876,942
Liabilities			
Deferred compensation liability	$ -	$ 26,120	$ 26,120
Interest rate swaps	-	2	2
Total liabilities at fair value	$ -	$ 26,122	$ 26,122

(in thousands)	June 30, 2018		
	Quoted In Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Total Fair Value
Assets			
Investments			
Cash and cash equivalents	$ 58,353	$ -	$ 58,353
Fixed income securities	257,691	40,228	297,919
Equity securities	394,172	8,028	402,200
Real estate investments	-	6,125	6,125
Total investments	710,216	54,381	764,597
Deferred compensation money market funds	1,255	-	1,255
Deferred compensation mutual funds	20,828	-	20,828
Beneficial interests held by 3rd party	-	830	830
Perpetual trusts held by 3rd party	-	7,527	7,527
Total assets at fair value	$ 732,299	$ 62,738	$ 795,037
Liabilities			
Deferred compensation liability	$ -	$ 22,083	$ 22,083
Interest rate swaps	-	19,116	19,116
Total liabilities at fair value	$ -	$ 41,199	$ 41,199

During 2019 and 2018, there were no transfers between Levels 1 and 2.

Following is a description of the Children's National valuation methodologies for assets and liabilities measured at fair value.

Fair value for Level 1 is based upon quoted prices in active markets that Children's National has the ability to access for identical assets and liabilities. Market price data is generally obtained from exchange or dealer markets. Children's National does not adjust the quoted price for such assets and liabilities. Level 1 investments include cash and cash equivalents including money market accounts, fixed income and equity securities, and mutual funds that are traded in an active exchange market.

Fair value for Level 2 is based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets. Inputs are obtained from various sources including market participants, dealers, and brokers. Level 2 investments include certain equity mutual funds, real estate investments, corporate bond funds, US government obligations, and federal agency obligations.

Interest rate swaps are valued using both observable and unobservable inputs, such as quotations received from the counterparty, dealers or brokers, whenever available and considered reliable. In instances where models are used, the value of the interest rate swap depends upon the contractual terms of, and specific risks inherent in, the instrument as well as the availability and reliability of observable inputs. Such inputs include market prices for reference securities, yield curves, credit curves, measures of volatility, prepayment rates, assumptions for nonperformance risk, and correlations of such inputs. The interest rate swap arrangements have inputs which can generally be corroborated by market data and are therefore classified within Level 2.

The fair value of the obligations under deferred compensation agreements approximates the fair value of the other investment assets, which are determined using quoted market prices. These assets are comprised of mutual funds and money market funds.

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

6. Property and Equipment

The components of property and equipment as of June 30 are summarized below:

(in thousands)	**2019**	**2018**
Land	$ 14,206	$ 12,042
Buildings and building improvements	985,792	948,848
Fixed and movable equipment	277,979	254,363
	1,277,977	1,215,253
Less: Accumulated depreciation	(797,826)	(738,457)
	480,151	476,796
Construction in progress	132,414	89,126
Property and equipment, net	$ 612,565	$ 565,922

Depreciation expense for the years ended June 30, 2019 and 2018 amounted to $65.1 million and $58.8 million, respectively.

In November 2016, the federal government conveyed through quitclaim deed, certain land and buildings to CNWR to be used for the protection of public health, including research. The property, which was recorded as Conveyance of Property within the Consolidated Statement of Changes in Net Assets at fair market value during the year ended June 30, 2017, consisted of land and buildings valued at $11.9 million and $33.5 million, respectively. The buildings are recorded in construction in progress at June 30, 2019. In connection with this transaction, CNWR recorded an environmental retirement obligation of $4.8 million of which the balance is $2.2 million and $4.6 million as of June 30, 2019 and 2018, respectively.

During the years ended June 30, 2019 and 2018, Children's National retired $5.7 million and $7.6 million, respectively, of fully depreciated long-lived assets determined to have no future value. Additionally during 2019, Children's National sold equipment with a net book value of $1.9 million for cash proceeds of $1.0 million, resulting in a loss on sale of $0.9 million. During 2018 Children's National sold land and property with a net book value of $2.2 million for cash proceeds of $4.5 million, resulting in a gain on sale of $2.3 million.

7. Contributions Receivable

Unconditional promises to give as of June 30 were as follows:

(in thousands)	**2019**	**2018**
Less than one year	$ 57,599	$ 61,662
One to five years	33,535	44,628
More than five years	18,390	22,640
	109,524	128,930
Less: Discount	(4,956)	(6,406)
Allowance for uncollectible contributions	(1,467)	(1,711)
Contribution receivable, net	$ 103,101	$ 120,813

Contributions receivable greater than one year in time are discounted using a rate of return that a market participant would expect to receive over the period at the date the pledge is received. The discount rate used is commensurate with the risk involved and ranges from 0.5% to 6.75% based on the date the pledge is made. Loss from uncollectible pledges was $13.2 million and $2.0 million for the years ended June 30, 2019 and 2018, respectively.

8. Investments and Assets Whose Use is Limited

The composition and fair values of investments and assets whose use is limited, as reported on the accompanying Consolidated Balance Sheets, at June 30 is as follows:

(in thousands)	2019		2018	
	Cost	Carrying Value	Cost	Carrying Value
Limited by terms of debt agreements				
Cash and cash equivalents	$ 19,694	$ 19,694	$ -	$ -
Total assets whose use is limited by terms of debt agreements	$ 19,694	$ 19,694	$ -	$ -
Limited for professional liability claims				
Cash and cash equivalents	$ 705	$ 705	$ 397	$ 397
Fixed income securities	18,007	18,276	14,520	14,083
Equity securities	11,240	11,879	9,053	9,255
Total funded professional liability	$ 29,952	$ 30,860	$ 23,970	$ 23,735
Investments				
Cash and cash equivalents	$ 126,056	$ 126,056	$ 57,956	$ 57,956
Fixed income securities	226,282	260,316	290,328	283,836
Equity securities	285,836	399,717	249,143	392,945
Equity method investments	61,141	4,037	53,262	6,100
Real Estate Investments	-	6,125	-	6,125
Total Investments	$ 699,315	$ 796,251	$ 650,689	$ 746,962
Interest in Beneficial Trusts				
Beneficial interests held by 3rd party	$ -	$ 816	$ -	$ 830
Perpetual trusts held by 3rd party	-	7,239	-	7,527
Total interest and beneficial trusts	$ -	$ 8,055	$ -	$ 8,357

Investments included approximately $242.9 million and $223.7 million at June 30, 2019 and 2018, respectively, of funds which are restricted by donors for specific programs or for capital improvements.

Investment returns consisted of the following:

(in thousands)	June 30, 2019		
	Without Donor Resctrions	With Donor Restrictions	Total
Dividends and interest income	$ 19,495	$ 5,776	$ 25,271
Loss on equity method investments	(9,942)	-	(9,942)
Realized gains	10,111	902	11,013
Investment income	19,664	6,678	26,342
Change in net unrealized gains on investments	7,398	4,368	11,766
Total investment returns, net	$ 27,062	$ 11,046	$ 38,108

(in thousands)	June 30, 2018		
	Without Donor Resctrions	With Donor Restrictions	Total
Dividends and interest income	$ 14,056	$ 4,498	$ 18,554
Loss on equity method investments	(10,549)	-	(10,549)
Realized gains	2,454	3,693	6,147
Investment income	5,961	8,191	14,152
Change in net unrealized gains on investments	12,822	6,649	19,471
Total investment returns, net	$ 18,783	$ 14,840	$ 33,623

Realized gains and losses are calculated by comparing proceeds upon sale of an investment to its original cost, or its cost less any adjustment recorded for other-than-temporary loss on investments where applicable. The change in unrealized gains and losses on investments reflects the increase or decrease during the period in the difference between the fair value and the carrying amount of securities.

The following tables show the gross unrealized losses and fair values of Children's National's investments and assets whose use is limited with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position:

(in thousands)

As of June 30, 2019	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Fixed Income	$ -	$ -	$ 70	$ (1)	$ 70	$ (1)
Equities	57	(1)	-	-	57	(1)
	$ 57	$ (1)	$ 70	$ (1)	$ 127	$ (2)

(in thousands)

As of June 30, 2018	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Fixed Income	$ 8,397	$ (365)	$ 249,293	$ (5,315)	$ 257,690	$ (5,680)

There were 4 and 11 investment positions in an unrealized loss position as of June 30, 2019 and 2018, respectively. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost of the investment. For the debt securities in an unrealized loss position, Children's National does not consider these investments to be other-than-temporarily impaired as of June 30, 2019 and 2018.

In October of 2013, Children's National and Inova Health Care Services ("Inova") partnered in a joint venture to create Pediatric Specialists of Virginia ("PSV"). PSV is a Virginia limited liability company which provides high-quality pediatric specialty care to the children of Northern Virginia through clinical excellence, innovation, education, research, and family-centered care. Children's National has a 50% investment in PSV, and it is accounted for under the equity method. Inova owns the remaining 50% of PSV.

PSV is governed by an eight-member Management Committee of which Children's National has four members. Any action by the Management Committee must be approved by a majority of the members, provided that it includes an affirmative vote by both one Inova representative and one Children's National representative.

Children's National's investment in PSV was $4.0 million and $6.1 million as of June 30, 2019 and 2018, respectively. Children's National's contributions to PSV during fiscal year 2019 included $7.9 million of cash contributions while fiscal year 2018 included $10.5 million of cash contributions. Children's National's share of losses from PSV as of June 30, 2019 and 2018, were $9.9 million and $10.5 million, respectively and are included within investment income in the Consolidated Statements of Operations.

The total assets, liabilities, and members' equity as of June 30, 2019 and 2018, and the total revenue, expenses and net loss for the years then ended for PSV are as follows:

(in thousands)	2019	2018
Total assets	$ 22,046	$ 20,604
Total liabilities	8,749	8,466
Members' equity	13,297	12,138
Total revenue	36,250	32,663
Total expenses	56,309	54,114
Net loss	$ (20,059)	$ (21,451)

9. Liquidity and Availability

As of June 30, 2019, financial assets and liquidity resources available within one year for general expenditure, such as operating expenses, scheduled principal payments on debt, and capital construction costs not financed with debt, were as follows:

(in thousands)	**2019**	**2018**
Financial assets		
Cash and cash equivalents	$ 71,929	$ 111,213
Short term investments	30,197	-
Short term assets whose use is limited by terms of debt agreement	19,694	-
Accounts receivable for patient services, net	195,047	180,494
Settlements due from third-party payors	7,714	7,506
Current contributions receivable without donor restrictions, net	13,086	12,200
Grants receivable	16,945	22,191
Total financial assets available within one year	354,612	333,604
Liquidity resources:		
Bank line of credit	50,000	-
Total financial assets and liquidity resources available within one year	$ 404,612	$ 333,604

As part of the Children's National's liquidity management plan, cash in excess of daily requirements is invested in either money market funds, short-term investments or long-term investments. Investment decisions are made based on anticipated liquidity needs, such that financial assets are available as general expenditures, liabilities, and other obligations come due. To manage liquidity, Children's National maintains a $50.0 million line of credit, as discussed in Note 11, *Debt.*

In addition, Children's National has board designated investments which are available for general expenditure upon Board approval. The amount of board designated investments was $468.1 million and $466.7 million as of June 30, 2019 and 2018, respectively.

Through its budgeting process, the CNMC Board authorizes access and release of board designated funds, transfer among CNMC and its affiliates, and transfers to operating accounts by taking action that approves the use of the funds. The CNMC Board also maintains banking and signature policies that authorize individual signers to transfer investment funds to the operating accounts. The CNMC Board may also rely upon the review and recommendations of its Finance and Investment Committee and the Board of its Affiliates.

10. Derivative Instruments

In October 2002, the Hospital entered into interest rate swap agreements in conjunction with the restructuring of its Series A tax-exempt bonds. The swaps were intended to protect the Hospital from increased debt service costs resulting from anticipated future increases in market interest rates.

Children's National recognizes their derivatives instruments as either assets or liabilities in the Consolidated Balance Sheets at fair value in accordance with relevant accounting guidance. The total notional amount of the 2002 interest rate swap agreement was $3.9 million and $7.6 million, respectively, as of June 30, 2019 and 2018.

In October 2005, the Hospital entered into an interest rate swap agreement (the 2005 swap) in conjunction with the issuance of $150 million in Series 2005-1, 2005-2 and 2005-3 tax-exempt bonds. The swap agreement hedged the variability of cash flows related to changes in market interest rates on the underlying variable-rate debt, effectively converting the variable-rate debt to a fixed rate issuance for the life of the debt outstanding. On April 9, 2008, the Hospital exercised its option to convert the interest rate on the Series 2005 bonds from the auction rate to a fixed rate of 5.45%. In June 2019, the Hospital terminated the 2005 swap in the amount of $24.2 million, which included accrued interest of $195 thousand. The total notional amount of the 2005 interest rate swap agreement was $135.6 million as of June 30, 2018.

Classification of derivatives in Consolidated Balance Sheets *(in thousands)*	**Fair Market Value** 2019	2018
Derivatives not designated as hedging instruments		
Liability on interest rate swap	$ 2	$ 19,116

Classification of derivatives (loss)/gain in Consolidated Statements of Operations *(in thousands)*	**Amount of (Loss)/Gain Recognized in Excess of Revenue Over Expense** 2019	2018
Derivatives not designated as hedging instrument		
Unrealized (loss)/gain on interest rate swap	$ 19,114	$ 8,093
Realized (loss)/gain on interest rate swap	(26,739)	(3,591)
Net realized and unrealized (loss)/gain on swap agreement	$ (7,626)	$ 4,502

11. Debt

As of June 30, long-term debt consisted of the following:

(in thousands)	**2019**	**2018**
Series 2015 bonds maturity between July 15, 2019 and July 15, 2044, interest rates ranging from 4.00% to 5.00%	$ 361,030	$ 364,280
Loan payable to Bank of America	100,000	75,000
Notes payable	18,820	-
Loan payable to Cerner	-	40
Total debt	479,850	439,320
Unamortized premiums and discounts, net	29,321	31,942
Unamortized debt issuance costs	(4,960)	(4,698)
	504,211	466,564
Less: Current portion	(5,879)	(5,911)
Total long-term debt	$ 498,332	$ 460,653

Series 2015 Bonds
In September 2015, the Children's National Obligated Group ("Obligated Group") borrowed from the District of Columbia (the "District") the proceeds of a series of tax exempt revenue refunding bonds ("Series 2015 Bonds") issued by the District in the principal amount of $374.0 million. The Obligated Group consists of Children's Hospital, CNWR (joined September 2016), and the Foundation. The Series 2015 Bonds were sold at a premium of $39.8 million which is being amortized using the effective interest method. The amortization expense for the years ended June 30, 2019 and 2018 was $2.6 million and $2.7 million, respectively. The proceeds were used to advance refund the outstanding Series 2008 and Series 2005 Bonds and pay the cost of issuance associated with the Series 2015 Bonds. The Series 2005 Bonds and the Series 2008 Bonds ($139.5 million and $248.6 million outstanding as of the advance refunding date, respectively) were issued or refinanced as tax-exempt revenue bonds with fixed interest rates and a final maturity date of July 2035 and July 2044, respectively. The Series 2005 Bonds and the Series 2008 Bonds each had a call provision where the bonds could not be redeemed until July 2018. On July 15, 2018 the bonds were redeemed for $394.2 million, including interest.

The Series 2015 Bonds are comprised of four tranches:

- $195,030,000 5.00% Serial Bonds due July 15, 2016 through July 15, 2035
- $40,315,000 4.00% Term Bonds due July 15, 2040
- $50,000,000 5.00% Term Bonds due July 15, 2040
- $88,615,000 5.00% Term Bonds due July 15, 2044

The most restrictive covenant for the Series 2015 Bonds requires the Obligated Group to maintain a minimum debt service coverage ratio of 1.2.

Bank of America Loan
In March 2013, the Hospital entered into a loan agreement with Bank of America ("BoA") to borrow $75.0 million. In June 2017, the loan agreement was amended and extended the maturity date of the loan to June 2020. Interest payments of LIBOR plus 44 basis points were due on the first of each month and the principal was to be due on the maturity date. The proceeds from the borrowing were to be used for general business purposes including increasing its cash reserve. In conjunction with the master borrowing agreement, BoA requires compliance with predetermined debt coverage ratios and a minimum cash balance.

In June 2019, the Hospital entered into an amended loan agreement with BoA for $100.0 million and extended the maturity date of the loan to June 1, 2024. Interest is accrued at the LIBOR Daily Floating Rate plus 54 basis points. The amended agreement requires payments of principal and interest, which are due monthly beginning August 1, 2019. The additional $25 million in borrowing was used to terminate Children's National's 2005 interest rate swap.

Notes Payable
On June 20, 2019, CITI NMTC SUBSIDIARY CDE XXXIV, LLC, a Delaware limited liability company, issued two loans to Building 52/53 Borrower providing historic and new market rehabilitation tax credit financing for two buildings and certain real property located at 7115 and 7125 13th Place, NW, Washington, D.C. known as Walter Reed Building 52 and Building 53.

The first loan, Promissory Note A1 in the amount of $6,132,174, accrues interest at 1.0% per year and is computed on the basis of a 360-day year, based upon four 90 day quarters. The loan has a 30-year term with interest only payments required until June 2026. Payments are due quarterly on the 1st day of each March, June, September and December. Upon the conclusion of the interest only period payments in the amount of $74,758, consisting of both interest and principal begin on September 1, 2026. The loan matures on June 20, 2049.

The second loan, Promissory Note B1 in the amount of $2,687,826, accrues interest at 1.0% per year and is computed on the basis of a 360-day year, based upon four 90 day quarters. The loan has a 30-year term with interest only payments required until June 2026. Payments are due quarterly on the 1st day of each March, June, September and December. Upon the conclusion of the interest only period payments in the amount of $32,768, consisting of both interest and principal begin on September 1, 2026. The loan matures on June 20, 2049.

On June 20, 2019, NTCIC-CNWR, LLC, a Delaware limited liability company, issued two loans to Building 52/53 Borrower providing historic and new market rehabilitation tax credit financing for Walter Reed Building 52 and Building 53.

The first loan, Promissory Note A2 in the amount of $7,363,526, accrues interest at 1.0% per year and is computed on the basis of a 360-day year, based upon four 90 day quarters. The loan has a 30-year term with interest only payments required until June 2026. Payments are due quarterly on the 1st day of each March, June, September and December. Upon the conclusion of the interest only period payments in the amount of $89,770, consisting of both interest and principal begin on September 1, 2026. The loan matures on June 20, 2049.

The second loan, Promissory Note B2 in the amount of $2,636,474, accrues interest at 1.0% per year and is computed on the basis of a 360-day year, based upon four 90 day quarters. The loan has a 30-year term with interest only payments required until June 2026. Payments are due quarterly on the 1st day of each March, June, September and December. Upon the conclusion of the interest only period payments in the amount of $32,142, consisting of both interest and principal begin on September 1, 2026. The loan matures on June 20, 2049.

The notes are collateralized by Building 52/53 Borrower's property and the improvements. Building 52/53 Borrower may not encumber, transfer ownership, relocate or otherwise act so as to decrease the value of all, or any portion of, the property without prior written consent. The notes are guaranteed by Children's National.

Line of Credit

On January 22, 2019, the Hospital entered into a $50.0 million line of credit agreement with Capital One National Association. The line of credit accrues interest at the LIBOR Daily Floating Rate plus 50 basis points. This agreement expires on January 22, 2020, subject to extension or earlier termination. No amounts were outstanding as of June 30, 2019.

Maturities and sinking fund requirements of long-term debt outstanding for the next 5 years and thereafter as of June 30, 2019 were as follows:
(in thousands)

2020	$	6,351
2021		10,838
2022		11,213
2023		11,608
2024		95,700
Thereafter		344,140
	$	479,850

Total interest expense was $21.3 million and $20.8 million for the years ended June 30, 2019 and 2018, respectively. Cash paid for interest was $22.1 million and $23.7 million for the years ended June 30, 2019 and 2018, respectively, and includes capitalized interest for construction projects of $0.9 million and $0.4 million, net of investment income for the year ended June 30, 2019 and 2018, respectively.

12. Endowments

Children's National endowment consists of individual donor restricted endowment funds for a variety of purposes. In addition, contributions receivables, split interest agreements, and other net assets have been designated for Children's National endowment.

The Board of Trustees of Children's National has interpreted the "Uniform Prudent Management of Institutional Funds Act" ("UPMIFA") as requiring the preservation 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, Children's National classifies net assets with donor restrictions (a time restriction in perpetuity), (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified as net assets with donor restrictions (a time restriction in perpetuity) is classified as net assets with donor restrictions (a purpose restriction) until those amounts are appropriated for expenditure by Children's National in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, Children's National considers the following factors in making a determination to appropriate or accumulate endowment funds:

(1) The duration and preservation of the fund;

(2) The purposes of Children's National and the donor-restricted endowment fund;

(3) General economic conditions;

(4) The possible effect of inflation and deflation;

(5) The expected total return from income and the appreciation of investments;

(6) Other resources of Children's National; and

(7) The investment policies of Children's National

Endowment net asset composition by type of fund for the years ended June 30 were as follows:

(in thousands)	2019		
	Without Donor Restrictions	With Donor Restrictions	Total
Donor-restricted endowment funds			
Historical gift value	$ -	$ 149,344	$ 149,344
Appreciation	-	46,793	46,793
Total endowment funds	$ -	$ 196,137	$ 196,137

(in thousands)	2018		
	Without Donor Restrictions	**With Donor Restrictions**	**Total**
Donor-restricted endowment funds			
Historical gift value	$ -	$ 146,896	$ 146,896
Appreciation	-	42,382	42,382
Total endowment funds	$ -	$ 189,278	$ 189,278

Changes in endowment net assets for the years ended June 30 were as follows:

(in thousands)	2019		
	Without Donor Restrictions	**With Donor Restrictions**	**Total**
Endowment net assets, beginning of year	$ -	$ 189,278	$ 189,278
Investment return, net	-	5,816	5,816
Net appreciation (realized and unrealized)	-	5,270	5,270
Total investment return	-	11,086	11,086
Redesignation of net assets	-	775	775
Gifts	-	1,443	1,443
Appropriation for expenditure	-	(6,445)	(6,445)
Endowment net assets, end of year	$ -	$ 196,137	$ 196,137

(in thousands)	2018		
	Without Donor Restrictions	**With Donor Restrictions**	**Total**
Endowment net assets, beginning of year	$ -	$ 172,347	$ 172,347
Investment return, net	-	4,543	4,543
Net appreciation (realized and unrealized)	-	10,341	10,341
Total investment return	-	14,884	14,884
Redesignation of net assets	-	185	185
Gifts	-	8,709	8,709
Appropriation for expenditure	-	(6,847)	(6,847)
Endowment net assets, end of year	$ -	$ 189,278	$ 189,278

Net Assets with Donor Restrictions in Perpetuity (Endowments Only)

The portion of perpetual endowment funds that is required to be retained permanently either by explicit donor stipulation or by UPMIFA as of June 30:

(in thousands)	2019	2018
Patient care	$ 53,532	$ 53,630
Health-related education	6,529	6,346
Research	89,283	86,920
	$ 149,344	$ 146,896

Endowment Funds With Deficits
From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the value of the initial and subsequent donor gift amounts (deficit). When donor endowment deficits exist, they are classified as a reduction of net assets with donor restrictions. There were no deficits in donor gift amounts as of June 30, 2019 and 2018.

Return Objectives and Risk Parameters
Children's National has adopted endowment investment and spending policies that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of endowment assets. Under this policy, the return objective for the endowment assets, measured over a full market cycle, shall be to maximize the return against a blended index, based on the endowment's target allocation applied to the appropriate individual benchmarks. Children's National expects its endowment funds over time, to provide an average rate of return of approximately 5% annually. Actual returns in any given year may vary from this amount.

Strategies Employed for Achieving Investment Objectives
To achieve its long-term rate of return objectives, Children's National relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized gains) and current yield (interest and dividends). Children's National targets a diversified asset allocation that places greater emphasis on equity-based investments to achieve its long-term objectives within prudent risk constraints.

Endowment Spending Allocation and Relationship of Spending Policy to Investment Objectives
The Board of Trustees of Children's National determines the method to be used to appropriate endowment funds for expenditure. Calculations were performed for individual endowment funds at a rate of 4.5% of the three-year rolling average using a monthly average over the most recent 36 months ended June 30, 2019. The corresponding calculated spending allocations were distributed annually in the first month of the fiscal year from the current net total or accumulated net total investment returns for individual endowment funds. In establishing this policy, the Board considered the expected long term rate of return on its endowment. Accordingly, over the long term, Children's National expects the current spending policy to allow its endowment to grow at between 3-8% annually, consistent with its intention to maintain the purchasing power of the endowment assets as well as to provide additional real growth through new gifts.

13. Net Assets with Donor Restrictions

Net assets with donor restrictions, consisting of cash, investments, and contributions receivable, were available for the following purposes at June 30,

(in thousands)	2019	2018
Patient care	$ 146,812	$ 141,733
Building expansion and equipment	3,248	2,776
Health-related education	8,202	6,497
Research	31,535	47,445
Endowment funds	149,344	146,896
Charitable remainder trusts	816	830
	$ 339,957	$ 346,177

14. Insurance

Children's National self-insures for malpractice and general liability claims up to a retention limit and carries excess coverage above that limit. On August 1, 1997, Children's National established the Captive as a wholly owned captive insurance company to assume the retained portion of medical malpractice, employment, and general liability claims of Children's National arising on or after August 1, 1997. Cash transfers to the Captive are based on premium levels established by the Captive's management, as well as Cayman Islands statutory capital requirements.

The reserve for claims shown in the accompanying Consolidated Balance Sheets represents the reserve for asserted and unasserted malpractice and comprehensive general liability claims against Children's National and its affiliated physicians. The reserve for claims is estimated by management using information supplied by legal counsel and an independent actuarial firm. Malpractice and other claims in excess of the reserve for claims have been asserted against Children's National, and it is possible that actual claim liabilities could differ from estimated amounts in the near term. However, management and legal counsel do not believe that the ultimate cost of resolving asserted and unasserted claims related to events having occurred through June 30, 2019 are materially in excess of the reserve for claims and malpractice insurance coverage.

Children's National also self-insures for employee health and dental claims. In addition, Children's National has a deductible of $500 thousand per occurrence for workers' compensation. Amounts accrued in the accompanying Consolidated Balance Sheets for the estimated cost of health and dental care claims incurred, including estimates for incurred but not reported amounts, were approximately $4.3 million and $4.5 million as of June 30, 2019 and 2018, respectively. Amounts accrued for workers compensation claims were approximately $2.6 million and $2.3 million as of June 30, 2019 and 2018, respectively.

15. Benefit Plans

Children's National sponsors a defined contribution retirement plan that is available to substantially all employees. Children's National makes contributions to the plan on behalf of each participant based on the employee's level of contribution. The cost of the plan to Children's National was approximately $24.3 million and $22.4 million as of June 30, 2019 and 2018, respectively.

Children's National also has incentive compensation plans, based on achievement of organizational and individual goals, and deferred compensation arrangements. Assets and liabilities related to the deferred compensation arrangements are included in other noncurrent assets and other noncurrent liabilities in the accompanying Consolidated Balance Sheets in the amount of approximately $31.8 million and $27.4 million as of June 30, 2019 and 2018, respectively.

16. Leases

Children's National operates certain property and equipment under capital leases and is obligated under several operating leases. The operating leases are primarily for the rental of space at auxiliary locations and for the use of certain office and lab equipment. Several of these leases contain escalation clauses, with fixed-rate increases ranging from 2% - 4%. Children's National has recorded a deferred rent liability of approximately $8.4 million and $6.0 million as of June 30, 2019 and 2018, respectively, which is included in deferred revenue in the accompanying Consolidated Balance Sheets.

Future minimum payments for the years ending June 30 are as follows:

(in thousands)	**Operating Leases**	**Capital Leases**
2020	$ 19,290	$ 3,134
2021	19,975	3,214
2022	18,057	3,300
2023	16,140	3,253
2024	14,427	3,082
2025 and thereafter	122,492	24,519
Total future minimum payments	210,381	40,502
Less: Amount representing interest	-	(14,840)
Present value of net minimum lease payments	$ 210,381	$ 25,662

As of June 30, 2019, the amount representing short-term and long-term interest is $2.0 million and $12.8 million, respectively.

Rent expense was $23.6 million and $21.5 million for the years ended June 30, 2019 and 2018, respectively.

Fixed assets under capital leases as of June 30 are as follows:

(in thousands)	**2019**	**2018**
Property and equipment under capital lease	$ 47,562	$ 30,956
Less: Accumulated depreciation	(26,101)	(26,172)
Property and equipment under capital leases, net	$ 21,461	$ 4,784

17. Concentrations of Credit Risk

Children's National grants credit without collateral to its patients, most of whom are local residents insured under third-party payor agreements. The mix of accounts receivable, net was as follows:

	2019	2018
Managed Care/Commercial	44 %	46 %
Maryland Medicaid	22	24
District of Columbia Medicaid	12	12
Virginia Medicaid and other	21	17
Self-pay	1	1
	100 %	100 %

18. Functional Expenses

Children's National provides health care services to children both within and outside its geographical service area. Children's National's consolidated financial statements report certain expense categories that are attributable to more than one health care service or support function. Therefore, these expenses require an allocation on a reasonable basis that is consistently applied. Costs not directly attributable to a function, including depreciation, amortization, interest and other occupancy costs, are allocated to a function based on a square footage or units of service basis. Expenses related to providing these services are as follows:

(in thousands)	June 30, 2019				
	Support Services		Program Services		
Operating expenses:	**Fundraising**	**Management and General**	**Patient Care**	**Research**	**Total**
Salaries, wages and benefits	$ 4,289	$ 177,186	$ 579,305	$ 52,344	$ 813,124
Supplies & other	4,033	122,710	189,074	32,671	348,488
Depreciation & amortization	13	23,225	33,992	7,870	65,100
Insurance	-	-	15,192	-	15,192
Interest	-	5,515	13,213	-	18,728
Development expense	22,070	4,946	-	-	27,016
Total operating expenses	30,405	333,582	830,776	92,885	1,287,648
Non-operating expenses:					
Interest expense on swap agreements	-	2,596	-	-	2,596
Total non-operating expenses	-	2,596	-	-	2,596
Total expenses	$ 30,405	$ 336,178	$ 830,776	$ 92,885	$ 1,290,244

(in thousands)	June 30, 2018				
	Support Services		Program Services		
Operating expenses:	**Fundraising**	**Management and General**	**Patient Care**	**Research**	**Total**
Salaries, wages and benefits	$ 5,161	$ 136,204	$ 565,773	$ 52,458	$ 759,596
Supplies & other	2,367	128,872	170,610	22,886	324,735
Depreciation & amortization	13	20,631	31,069	7,045	58,758
Insurance	-	-	11,688	-	11,688
Interest	-	4,698	12,463	-	17,161
Development expense	21,742	4,418	-	-	26,160
Total operating expenses	29,283	294,823	791,603	82,389	1,198,098
Non-operating expenses:					
Interest expense on swap agreements	-	3,592	-	-	3,592
Total non-operating expenses	-	3,592	-	-	3,592
Total expenses	$ 29,283	$ 298,415	$ 791,603	$ 82,389	$ 1,201,690

19. Noncontrolling Interests

The following table reconciles the carrying amounts of Children's National's controlling interest and the noncontrolling interests for net assets without donor restrictions:

(in thousands)	**Total**	**Controlling Interest**	**Noncontrolling Interests**
Balance at June 30, 2018	$ 707,500	$ 707,500	$ -
Excess of revenues over expenses	34,305	34,305	-
Unrealized gain on investments	7,398	7,398	-
Contributions from noncontrolling interests	7,592	-	7,592
Released from restrictions for property and equipment	1,508	1,508	-
Other changes in net assets without donor restrictions	(2,477)	(2,477)	-
Balance at June 30, 2019	$ 755,826	$ 748,234	$ 7,592

20. Commitments and Contingencies

Children's National is involved in litigation and regulatory investigations arising in the ordinary course of business. After consulting with legal counsel, management estimates that these matters will be resolved without material adverse effect on Children's National's future financial position or results from operations.

21. Subsequent Events

Subsequent events have been evaluated by management through October 4, 2019 which, is the date the consolidated financial statements were issued, and other than disclosed below, there are no other matters requiring disclosure in the financial statements as of June 30, 2019.

On September 1, 2019, Children's National became the sole member of the HSC Foundation and subsidiaries. No consideration was paid by Children's National to become the sole member of HSC Foundation and subsidiaries.

Supplementary Consolidating Information

pwc

Report of Independent Auditors

To the Board of Trustees of
Children's National Medical Center:

We have audited the consolidated financial statements of Children's National Medical Center its subsidiaries ("Children's National") as of and for the year ended June 30, 2019 and our report thereon appears on pages 1 and 2 of this document, which included an unmodified opinion on those financial statements and a paragraph describing the change in the manner in which Children's National presents net assets and reports certain aspects of its financial statements as a not-for-profit entity and the manner in which it accounts for revenue from contracts with customers in 2019. That audit was conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The consolidating information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The consolidating information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves and other additional procedures, in accordance with auditing standards generally accepted in the United States of America. In our opinion, the consolidating information is fairly stated, in all material respects, in relation to the consolidated financial statements taken as a whole. The consolidating information is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position, results of operations, changes in net assets and cash flows of the individual companies and is not a required part of the consolidated financial statements. Accordingly, we do not express an opinion on the financial position, results of operations, changes in net assets and cash flows of the individual companies.

PricewaterhouseCoopers LLP

October 4, 2019

PricewaterhouseCoopers LLP, 1800 Tysons Boulevard, McLean, VA 22102-4261
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Children’s National Medical Center and Subsidiaries
Supplementary Consolidating Balance Sheet
June 30, 2019

(in thousands)	Obligated group: Hospital	Obligated group: CNWR	Obligated group: Foundation	Obligated group: Eliminations	Obligated Group Total	CRI	Safekids	CP&A	CSS	PHN/CNHN	Other	Captive	Eliminations	Consolidated Total
Assets														
Current assets														
Cash and cash equivalents	$ 59,181	$ -	$ 1,666	$ -	$ 60,847	$ -	$ (18)	$ (390)	$ (3)	$ -	$ 10,636	$ 857	$ -	$ 71,929
Short term Investments	30,197	-	-	-	30,197	-	-	-	-	-	-	-	-	30,197
Short term assets whose use is limited by terms of debt	-	-	-	-	-	-	-	-	-	-	19,694	-	-	19,694
Accounts receivable, net	193,493	-	-	-	193,493	-	-	1,554	-	-	-	-	-	195,047
Settlements due from third-party payors	7,714	-	-	-	7,714	-	-	-	-	-	-	-	-	7,714
Contributions receivable, net	-	-	53,243	-	53,243	-	3,652	-	-	-	-	-	-	56,895
Grant receivable	2,138	-	-	-	2,138	10,923	98	-	3,786	-	-	-	-	16,945
Inventories of supplies	11,196	-	-	-	11,196	-	-	768	-	-	-	-	-	11,964
Prepaid expenses and other	54,246	-	-	-	54,246	8	186	425	-	889	15	1,509	(20,320)	36,958
Total current assets	358,165	-	54,909	-	413,074	10,931	3,918	2,357	3,783	889	30,345	2,366	(20,320)	447,343
Property and equipment, net	513,221	54,460	154	-	567,835	18,933	976	3,829	-	-	20,992	-	-	612,565
Assets whose use is limited by professional liability claims	705	-	-	-	705	-	-	-	-	-	-	30,155	-	30,860
Investments	737,998	-	549,721	(565,964)	721,755	39,969	491	-	-	-	-	43,809	(39,970)	766,054
Contributions receivable, net	-	-	45,704	-	45,704	-	502	-	-	-	-	-	-	46,206
Loan receivable	13,496	-	-	-	13,496	-	-	-	-	-	-	-	-	13,496
Interest in beneficial trusts	-	-	8,055	-	8,055	-	-	-	-	-	-	-	-	8,055
Due from affiliates	408,627	-	-	(72,592)	336,035	-	1,125	-	-	-	-	-	(337,160)	-
Other	46,077	-	-	-	46,077	-	-	824	-	-	(2,446)	-	(9,836)	34,619
Total noncurrent assets	1,720,124	54,460	603,634	(638,556)	1,739,662	58,902	3,094	4,653	-	-	18,546	73,964	(386,966)	1,511,855
Total assets	$ 2,078,289	$ 54,460	$ 658,543	$ (638,556)	$ 2,152,736	$ 69,833	$ 7,012	$ 7,010	$ 3,783	$ 889	$ 48,891	$ 76,330	$ (407,286)	$ 1,959,198

(in thousands)	Obligated group: Hospital	Obligated group: CNWR	Obligated group: Foundation	Obligated group: Eliminations	Obligated Group Total	CRI	Safekids	CP&A	CSS	PHN/CNHN	Other	Captive	Eliminations	Consolidated Total
Liabilities and Net Assets														
Current liabilities														
Accounts payable	$ 41,623	$ -	$ -	$ -	$ 41,623	$ -	$ 170	$ 105	$ -	$ -	$ 5,717	$ 820	$ -	$ 48,435
Accrued salaries and other expenses	117,426	14	798	-	118,238	2,527	244	4,230	1,233	102	-	-	-	126,574
Current portion of reserve for claims	24,710	-	-	-	24,710	-	-	-	-	-	-	20,320	(20,320)	24,710
Settlements due to third-party payors	1,226	-	-	-	1,226	-	-	-	-	-	-	-	-	1,226
Deferred revenue	13,525	-	153	-	13,678	9,253	1,735	1,761	-	-	-	-	-	26,427
Current portion of long-term debt	5,879	-	-	-	5,879	-	-	-	-	-	-	-	-	5,879
Current portion of capital lease obligations	1,033	-	-	-	1,033	-	-	97	-	-	-	-	-	1,130
Total current liabilities	205,422	14	951	-	206,387	11,780	2,149	6,193	1,233	102	5,717	21,140	(20,320)	234,381
Noncurrent liabilities														
Long-term debt	479,959	-	-	-	479,959	-	-	-	-	-	18,373	-	-	498,332
Long-term capital lease obligations	23,643	-	-	-	23,643	-	-	889	-	-	-	-	-	24,532
Reserve for claims	68,955	-	-	-	68,955	-	-	-	-	-	-	9,836	(9,836)	68,955
Due to affiliates	-	21,295	51,297	(72,592)	-	312,379	-	21,092	3,411	278	-	-	(337,160)	-
Interest rate swaps	2	-	-	-	2	-	-	-	-	-	-	-	-	2
Other long-term liabilities	33,126	2,914	362	-	36,402	-	-	811	-	-	-	-	-	37,213
Total noncurrent liabilities	605,685	24,209	51,659	(72,592)	608,961	312,379	-	22,792	3,411	278	18,373	9,836	(346,996)	629,034
Total liabilities	811,107	24,223	52,610	(72,592)	815,348	324,159	2,149	28,985	4,644	380	24,090	30,976	(367,316)	863,415

(in thousands)	Obligated group: Hospital	Obligated group: CNWR	Obligated group: Foundation	Obligated group: Eliminations	Obligated Group Total	CRI	Safekids	CP&A	CSS	PHN/CNHN	Other	Captive	Eliminations	Consolidated Total
Net assets (deficit)														
Without donor restrictions - controlling interest	971,839	30,237	270,621	(270,621)	1,002,076	(294,295)	218	(21,975)	(861)	509	17,209	45,354	(1)	748,234
Without donor restrictions - noncontrolling interest	-	-	-	-	-	-	-	-	-	-	7,592	-	-	7,592
With donor restrictions	295,343	-	335,312	(295,343)	335,312	39,969	4,645	-	-	-	-	-	(39,969)	339,957
Total net assets (deficit)	1,267,182	30,237	605,933	(565,964)	1,337,388	(254,326)	4,863	(21,975)	(861)	509	24,801	45,354	(39,970)	1,095,783
Total liabilities and net assets (deficit)	$ 2,078,289	$ 54,460	$ 658,543	$ (638,556)	$ 2,152,736	$ 69,833	$ 7,012	$ 7,010	$ 3,783	$ 889	$ 48,891	$ 76,330	$ (407,286)	$ 1,959,198

Children’s National Medical Center and Subsidiaries
Supplementary Consolidating Statement of Operations
Year Ended June 30, 2019

(in thousands)	Obligated Group													
	Hospital	CNWR	Foundation	Eliminations	Obligated Group Total	CRI	Safekids	CP&A	CSS	PHN/CNHN	Other	Captive	Eliminations	Consolidated Total
Operating revenue and other support														
Net patient service revenue	$ 1,061,055	$ -	$ -	$ -	$ 1,061,055	$ -	$ 3	$ 29,540	$ -	$ -	$ -	$ -	$ -	$ 1,090,598
Grant revenue	8,927	-	-	-	8,927	55,392	339	747	21,905	-	-	-	-	87,310
Other operating revenue	89,463	-	23	(3,935)	85,551	684	1,799	450	-	1,371	-	10,491	(34,970)	65,376
Contributions	48	-	23,173	-	23,221	1	1,423	-	-	-	-	-	-	24,645
Net assets released from restrictions used for operations	14,706	-	12,655	-	27,361	8,745	6,770	-	-	-	-	-	-	42,876
Total operating revenue and other support	1,174,199	-	35,851	(3,935)	1,206,115	64,822	10,334	30,737	21,905	1,371	-	10,491	(34,970)	1,310,805
Expenses														
Salaries, wages, and benefits	717,150	346	-	-	717,496	49,974	4,139	20,702	18,864	1,949	-	-	-	813,124
Supplies and other	305,319	2,837	-	(3,935)	304,221	45,388	6,077	11,945	2,723	729	92	1,792	(24,479)	348,488
Depreciation and amortization	62,143	-	-	-	62,143	2,369	119	469	-	-	-	-	-	65,100
Provision for insurance	13,907	-	-	-	13,907	62	-	214	35	-	-	11,465	(10,491)	15,192
Interest and amortization	18,623	52	-	-	18,675	-	-	53	-	-	-	-	-	18,728
Development expense	-	-	27,016	-	27,016	-	-	-	-	-	-	-	-	27,016
Total expenses	1,117,142	3,235	27,016	(3,935)	1,143,458	97,793	10,335	33,383	21,622	2,678	92	13,257	(34,970)	1,287,648
Operating income (loss)	57,057	(3,235)	8,835	-	62,657	(32,971)	(1)	(2,646)	283	(1,307)	(92)	(2,766)	-	23,157
Non-operating revenues and expenses														
Investment return, net	(4,949)	-	23,417	-	18,468	-	-	-	-	-	-	1,196	-	19,664
Realized and change in unrealized fair value of interest rate swaps	(7,626)	-	-	-	(7,626)	-	-	-	-	-	-	-	-	(7,626)
Other non-operating loss, net	(874)	-	-	-	(874)	(16)	-	-	-	-	-	-	-	(890)
Total non-operating revenues and expenses	(13,449)	-	23,417	-	9,968	(16)	-	-	-	-	-	1,196	-	11,148
Excess (deficiency) of revenues over expenses	$ 43,608	$ (3,235)	$ 32,252	$ -	$ 72,625	$ (32,987)	$ (1)	$ (2,646)	$ 283	$ (1,307)	$ (92)	$ (1,570)	$ -	$ 34,305

1. Basis of Presentation—Consolidating Supplementary Information

The consolidating supplementary information ("consolidating information") presented on pages 42-43 was derived from and relates to the underlying accounting and other records used to prepare the consolidated financial statements. The consolidating information is presented for purposes of additional analysis of the consolidated financial statements, rather than to present the financial position and results of operations, changes in net assets and cash flows of the individual companies within Children's National, and is not a required part of the consolidated financial statements. The individual companies within Children's National as presented within the consolidating information are disclosed within Note 1 to the consolidated financial statements.