KPMG

# CHILDREN'S HEALTH CARE

Consolidated Financial Statements

December 31, 2020 and 2019

(With Independent Auditors' Report Thereon)

**CHILDREN'S HEALTH CARE**

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KPMG LLP
4200 Wells Fargo Center
90 South Seventh Street
Minneapolis, MN 55402

# Independent Auditors' Report

The Board of Directors
Children's Health Care
Minneapolis, Minnesota:

We have audited the accompanying consolidated financial statements of Children's Health Care and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 2020 and 2019, and the related consolidated statements of operations and changes in net assets and cash flows for the years then ended, and the related notes to the consolidated financial statements.

*Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of 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 these 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 the auditors' 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, the auditor considers internal control relevant to the entity'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 the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the 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 Health Care and its subsidiaries as of December 31, 2020 and 2019, and the results of their operations and their cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.

*Other Matter*

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The 2020 supplemental consolidating financial information on pages 46 to 48 are presented for the purpose of additional analysis of the consolidated financial statements and are not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The 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 themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, such schedules are fairly stated in all material respects in relation to the consolidated financial statements as a whole.

KPMG LLP

Minneapolis, Minnesota
April 12, 2021

**CHILDREN'S HEALTH CARE**

Consolidated Balance Sheets

December 31, 2020 and 2019

(In thousands)

| **Assets** | | **2020** | **2019** |
|---|---|---|---|
| Current assets: | | | |
| Cash and cash equivalents | $ | 27,090 | 19,106 |
| Short-term investments | | 5,894 | 9,263 |
| Short-term investments, board-designated | | 84 | 133 |
| Funds held by trustee | | 7 | 3,131 |
| Patient accounts receivable | | 121,421 | 154,783 |
| Prepaid expenses and other current assets | | 48,230 | 46,418 |
| Total current assets | | 202,726 | 232,834 |
| Long-term investments | | 938,521 | 738,223 |
| Board-designated investments | | 123,331 | 117,638 |
| Operating lease right-of-use assets, net | | 37,403 | 39,470 |
| Other assets | | 79,837 | 76,648 |
| Land, buildings, and equipment – net | | 308,026 | 328,160 |
| Total | $ | 1,689,844 | 1,532,973 |
| **Liabilities and Net Assets** | | | |
| Current liabilities: | | | |
| Current maturities of long-term debt | $ | 2,113 | 9,657 |
| Current portion of operating lease liabilities | | 5,894 | 5,267 |
| Accounts payable and accrued expenses | | 44,207 | 47,850 |
| Accrued salaries, wages, and benefits | | 59,820 | 69,112 |
| Other current liabilities | | 15,127 | 11,545 |
| Total current liabilities | | 127,161 | 143,431 |
| Fair value of interest rate swaps | | 25,251 | 25,883 |
| Other long-term liabilities | | 26,056 | 17,352 |
| Long-term portion of operating lease liabilities | | 42,842 | 44,704 |
| Long-term debt – excluding current maturities | | 292,404 | 163,081 |
| Total liabilities | | 513,714 | 394,451 |
| Net assets: | | | |
| Net assets without donor restrictions | | 1,098,982 | 1,064,323 |
| Net assets with donor restrictions | | 77,148 | 74,199 |
| Total net assets | | 1,176,130 | 1,138,522 |
| Total | $ | 1,689,844 | 1,532,973 |

See accompanying notes to consolidated financial statements.

**CHILDREN'S HEALTH CARE**

Consolidated Statements of Operations and Changes in Net Assets

Years ended December 31, 2020 and 2019

(In thousands)

| | | 2020 | 2019 |
|---|---|---|---|
| Revenue: | | | |
| Patient service revenue | $ | 786,546 | 922,840 |
| Net assets released from restrictions for operations | | 6,343 | 10,890 |
| Other | | 89,316 | 42,357 |
| Total revenue | | 882,205 | 976,087 |
| Expenses: | | | |
| Salaries, wages, and employee benefits | | 519,041 | 553,991 |
| Professional fees and purchased services | | 120,064 | 129,736 |
| Supplies | | 101,268 | 107,268 |
| Facilities | | 17,569 | 17,257 |
| Depreciation and amortization | | 50,646 | 44,990 |
| Financing costs | | 10,496 | 7,586 |
| Health services taxes | | 25,683 | 28,317 |
| Other | | 59,258 | 54,495 |
| Total expenses | | 904,025 | 943,640 |
| Operating (loss) income | | (21,820) | 32,447 |
| Nonoperating gains (losses): | | | |
| Investment income and realized gains | | 15,716 | 33,811 |
| Income on investments accounted for under the equity method | | 404 | 2,646 |
| Net unrealized gains on investments | | 46,751 | 55,607 |
| Change in fair value of interest rate swaps | | (5,206) | (5,135) |
| Nonservice component of pension expense | | (550) | (1,306) |
| Total nonoperating gains | | 57,115 | 85,623 |
| Excess of revenues over expenses | | 35,295 | 118,070 |

**CHILDREN'S HEALTH CARE**

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

Years ended December 31, 2020 and 2019

(In thousands)

| | | 2020 | 2019 |
|---|---|---|---|
| Net assets without donor restrictions: | | | |
| Excess of revenue over expenses | $ | 35,295 | 118,070 |
| Net assets released from restrictions – capital acquisitions | | — | 1,165 |
| RSVP plan-related changes other than net periodic plan expense | | (636) | 228 |
| Other | | — | (52) |
| Increase in net assets without donor restrictions | | 34,659 | 119,411 |
| Net assets with donor restrictions: | | | |
| Contributions | | 4,478 | 8,450 |
| Investment income | | 654 | 2,283 |
| Net unrealized gains on investments | | 3,865 | 3,541 |
| Net assets released from restrictions – operations | | (6,343) | (10,890) |
| Net assets released from restrictions – capital acquisitions | | — | (1,165) |
| Change in value of perpetual trusts held by others | | 295 | 470 |
| Increase in net assets with donor restrictions | | 2,949 | 2,689 |
| Increase in net assets | | 37,608 | 122,100 |
| Net assets – beginning of year | | 1,138,522 | 1,016,422 |
| Net assets – end of year | $ | 1,176,130 | 1,138,522 |

See accompanying notes to consolidated financial statements.

**CHILDREN'S HEALTH CARE**

Consolidated Statements of Cash Flows

Years ended December 31, 2020 and 2019

(In thousands)

| | | 2020 | 2019 |
|---|---|---|---|
| Cash flows from operating activities: | | | |
| Increase in net assets | $ | 37,608 | 122,100 |
| Adjustments to reconcile increase in net assets to net cash provided by operating activities: | | | |
| Depreciation and amortization | | 50,646 | 44,990 |
| Net unrealized gains on investments | | (50,618) | (59,148) |
| Net realized gains on investments | | (24,170) | (5,764) |
| RSVP plan-related changes other than net periodic plan expense | | 636 | (228) |
| Change in fair value of interest rate swaps | | 5,206 | 5,135 |
| Contributions restricted for long-lived purposes | | (80) | (31) |
| Income on investments accounted for under the equity method | | (404) | (2,646) |
| Other | | 59 | (734) |
| Extinguishment of debt acquisition costs | | 2,357 | — |
| Changes in assets and liabilities: | | | |
| Patient accounts receivable | | 33,362 | 11,503 |
| Prepaid expenses and other current assets | | (2,053) | (2,259) |
| Other assets | | (4,996) | 5,809 |
| Accounts payable and accrued expenses | | 527 | 7,924 |
| Accrued salaries, wages, and benefits | | (9,292) | 748 |
| Other liabilities | | 11,058 | (9,709) |
| Net cash provided by operating activities | | 49,846 | 117,690 |
| Cash flows from investing activities: | | | |
| Distributions received from joint ventures | | — | 2,309 |
| Purchase of land, buildings, and equipment | | (30,127) | (30,430) |
| Purchase of investments and funds held by trustee | | (823,635) | (293,959) |
| Cash paid in acquisitions, net | | — | (3,900) |
| Proceeds from sale and maturities of investments and funds held by trustee | | 698,183 | 223,726 |
| Net cash used in investing activities | | (155,579) | (102,254) |
| Cash flows from financing activities: | | | |
| Principal payments on long-term debt | | (2,275) | (9,545) |
| Proceeds from Issuance of long-term debt, net | | 297,306 | — |
| Retirement of long-term debt | | (173,220) | — |
| Deferred debt acquisition costs | | (2,577) | — |
| Settlement of interest of swaps | | (5,838) | — |
| Contributions restricted for long-lived purposes | | 321 | 381 |
| Net cash provided by (used in) financing activities | | 113,717 | (9,164) |
| Net increase in cash and cash equivalents | | 7,984 | 6,272 |
| Cash and cash equivalents – beginning of year | | 19,106 | 12,834 |
| Cash and cash equivalents – end of year | $ | 27,090 | 19,106 |
| Supplemental cash flow disclosures: | | | |
| Cash paid for interest | $ | 5,256 | 4,602 |
| Noncash gifts of property and equipment, and investments | | 514 | 1,146 |

See accompanying notes to consolidated financial statements.

## (1) Organization and Summary of Significant Accounting Policies

### *(a) Organization*

Children's Health Care (Children's), d/b/a Children's Hospitals and Clinics of Minnesota, is a not-for-profit corporation organized under the laws of the State of Minnesota for the treatment and care of infants, children, and adolescents and the promotion and administration of charitable care, research, and educational activities.

Children's owns and operates two tertiary facilities, Children's – Minneapolis and Children's – St. Paul, that operate under one provider license from the State of Minnesota; two separate and controlled not-for-profit corporations, Children's Health Care Services, Inc., d/b/a Children's – Minnetonka, and Children's Health Care Foundation, d/b/a Children's Foundation (the Children's Foundation); and three affiliate organizations, Children's Health Insurance Network, Ltd. (CHIN), which handles professional liability claims (note 6), Children's Clinic Network, which owns and operates community-based clinics, and Children's Minnesota Home Medical Equipment (CHME), which provides home medical equipment services. Children's is also the sole corporate and nonvoting member of Children's Health Network (CHN), a clinically integrated network created by Children's to be a leading advocate for providing the highest quality of care for children and their families. The consolidated financial statements include the accounts of Children's and its subsidiaries. The "Obligated Group" consists of, collectively, Children's – Minneapolis; Children's – St. Paul; and Corporate, plus the subsidiaries, Children's – Minnetonka, Children's Foundation, and Children's Clinic Network.

### *(b) Basis of Presentation*

The consolidated financial statements are prepared on the accrual basis of accounting.

### *(c) Consolidation*

All significant intercompany accounts and transactions have been eliminated in the consolidated financial statements. Investments in entities that Children's does not control, but which Children's has a substantial ownership interest and can exercise significant influence, are accounted for using the equity method. Investments in entities that Children's does not control, does not have a substantial ownership interest, and cannot exercise significant influence are accounted for using the cost method.

### *(d) Mother Baby Joint Operating Agreement and Center*

Children's has a joint operating agreement with Allina Health (Allina), a Minnesota not-for-profit corporation, to collaborate on certain obstetric, normal newborn, perinatology, and neonatal service lines. The joint operating agreement is herein referred to as the "Mother Baby" program and is governed by a joint operating committee with equal membership from Children's and Allina for a 20-year term, with extension provisions, that began on January 1, 2011. Under this collaborative arrangement, there is an equalization payment whereby Children's receives 72% of the cash flows related to these service lines, as defined in the agreement, and Allina receives 28% of the cash flows related to these service lines. Net equalization costs are reported as other operating expenses and were $22,597 and $10,980 for the years ended December 31, 2020 and 2019, respectively. The amount due to Allina was $5,722 and $4,500 at December 31, 2020 and 2019, respectively, which is included in accounts payable and accrued expenses in the consolidated balance sheets.

Buildings and equipment for the Mother Baby program and the related depreciation expense are accounted for using proportional accounting. Under proportional accounting, Children's records Mother Baby program capital assets that it acquires, recognizes the related depreciation and amortization as a program expense, and then shares in the cash flow impact of the capital expenditures at 72%, as noted above.

***(e) Use of Estimates***

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the consolidated financial statements. Estimates also affect the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. Significant estimated amounts in the consolidated financial statements include explicit and implicit price concessions, and valuation of investments.

***(f) Subsequent Events***

Children's has evaluated all events or transactions that occurred after December 31, 2020 through April 12, 2021, the date the consolidated financial statements were issued. Children's is not aware of any material subsequent events that would require recognition or disclosure in the consolidated financial statements.

***(g) Cash and Cash Equivalents***

All short-term investments purchased with a maturity of three months or less and not otherwise classified as noncurrent assets are considered to be cash and cash equivalents and are carried at fair value.

***(h) Recently Adopted Accounting Standards***

Effective January 1, 2019 Children's adopted Accounting Standards Update (ASU) No. 2018-08, *Clarifying the Scope and Accounting for Contributions Received and Made*. ASU No. 2018-08 clarifies and improves the scope and the accounting guidance to determine when a transaction should be accounted for as an exchange transaction or a contribution and how to determine whether a contribution is conditional. The adoption of ASU No. 2018-08 did not have a material effect on the consolidated financial statements.

***(i) Recently Issued Accounting Standards***

In August 2016, the Financial Accounting Standards Board (FASB) issued ASU No. 2018-15, *Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract*. ASU No. 2018-15 aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software. The provisions of ASU No. 2018-15 are effective for annual periods beginning after December 31, 2020. Children's does not believe the new guidance will have a material impact on the consolidated financial statements.



(Continued)

### *(j) Patient Service Revenue*

Patient service revenue is reported at the amount that reflects the consideration to which Children's 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 and includes variable consideration for retroactive revenue adjustments due to settlement of audits, reviews, and investigations. Generally, Children's bills the patients 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. Revenue for performance obligations satisfied over time is recognized based on actual charges incurred in relation to total expected (or actual) charges. Children's 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 in Children's hospitals receiving inpatient acute care and outpatient services. Children's 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 services are provided and Children's 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 has elected to apply the optional exemption provided in FASB ASC 606-10-50-14(a) and, therefore, is not required to disclose the aggregate amount of the transaction price allocated to performance obligations that are unsatisfied or partially unsatisfied at the end of the reporting period. The unsatisfied or partially unsatisfied performance obligations referred to above 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.

As provided for under the guidance, Children's does not adjust the promised amount of consideration from patients and third-party payors for the effects of a significant financing component due to the 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.

Children's uses a portfolio approach to apply the revenue recognition model to classes of payors with similar characteristics and analyzes cash collection trends over an appropriate collection look-back period depending on the payor.

Children's determines the transaction price based on standard charges for goods and services provided, reduced by explicit price concessions provided to third-party payors, explicit price concessions provided to uninsured patients in accordance with Children's policies, and/or implicit price concessions provided to un- or underinsured patients. Children's determines its estimates of explicit price concessions based on contractual agreements, its discount policies, and historical experience. Children's determines its estimate of implicit price concessions based on its historical collection experience with this class of patients.

Agreements with third-party payors typically provide for payments at amounts less than established charges. A summary of the payment arrangements with major third-party payors follows:

- Government payors: Reimbursement for government payors is generally paid based upon established fee schedules. Outpatient services are paid using prospectively determined rates.
- Other third-party payors, including commercial: Payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations provide for payment using prospectively determined rates per discharge, discounts with established charges, and prospectively determined daily rates.

Children's recognizes that revenue and receivables from third-party payors, including governmental agencies, are significant to its operations but does not believe there are significant credit risks associated with these organizations. In 2020, the top four third-party payors accounted for 32%, 24%, 21%, and 17% of patient service revenue. In 2019, the top four third-party payors accounted for 26%, 26%, 21%, and 17% of patient service revenue.

Children's grants credit without collateral to its patients, most of whom are insured under third-party payor agreements. The mix of receivables from patients and third-party payors, net of explicit and implicit price concessions at December 31, 2020 and 2019 was as follows:

| | 2020 | 2019 |
|---|---|---|
| Government payors | 24 % | 18 % |
| Other third-party payors | 58 | 66 |
| Patients | 18 | 16 |
| | 100 % | 100 % |

Patient service revenue recognized for the years ended December 31, 2020 and 2019, by major payor source, was as follows:

| | 2020 | | 2019 | |
|---|---|---|---|---|
| | Inpatient | Outpatient | Inpatient | Outpatient |
| Government payors | $ 179,473 | 68,922 | 162,638 | 78,814 |
| Other third-party payors | 322,971 | 208,254 | 411,319 | 251,751 |
| Self-pay | 2,596 | 4,330 | 4,212 | 14,106 |
| Patient service revenue | $ 505,040 | 281,506 | 578,169 | 344,671 |



(Continued)

Laws and regulations concerning government programs, including Medicare and Medicaid, are complex and subject to varying interpretation. As a result of investigations by governmental agencies, various healthcare organizations have received requests for information and notices regarding alleged noncompliance with those laws and regulations, which, in some instances, have resulted in organizations entering into significant settlement agreements. 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 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. In addition, the contracts Children's has with commercial payors also provide for retroactive audit and review of claims.

Settlements with third-party payors 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 historical settlement activity, including an assessment to ensure that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the retroactive adjustment is subsequently resolved. Estimated settlements are adjusted in future periods as adjustments become known (i.e., new information becomes available), or as years are settled or are no longer subject to such audits, reviews, and investigations. Adjustments arising from a change in the transaction price were not significant for the years ended December 31, 2020 and 2019.

Generally, patients who are covered by third-party payors are responsible for related deductibles and coinsurance, which vary in amount. Children's also provides services to uninsured patients and offers those uninsured patients a discount, either by policy or law, from standard charges. Children's estimates the transaction price for patients with deductibles and coinsurance and from those who are uninsured 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.

Consistent with Children's mission, care is provided to patients regardless of their ability to pay. Therefore, Children's has determined it has provided implicit price concessions to uninsured patients and patients with other uninsured balances (e.g., co-pays and deductibles). The implicit price concessions included in estimating the transaction price represent the difference between amounts billed to patients and the amounts Children's expects to collect based on its collection history with those patients.

Patients who meet Children's criteria for charity care are provided care without charge or at amounts less than established rates. Such amounts determined to qualify as charity care are not reported as revenue.

***(k) Investments***

Investments are carried at fair value, which generally are based on quoted market prices at December 31, 2020 and 2019. Certain investments are valued at net asset value of the underlying fund as a practical expedient to fair value. Funds held by trustee are held under bond indenture agreements for debt service payments. The estimated values as determined by the respective funds' general partner or investment manager may differ significantly from the values that would have been used had ready markets existed. A portion of investments are not intended to be used for current operations and, therefore, are classified as noncurrent assets. Realized gains and losses on sales of securities are recognized using the average cost basis.

Children's classifies its investments as trading securities. Children's invests in various securities, which may include corporate equities, corporate bonds, municipal bonds, U.S. government obligations, mortgage and asset-backed securities, limited partnerships, foreign investments, foreign currency contracts, mutual funds, exchange-traded futures and options, and swap contracts. Investment securities, in general, are exposed to various market risks, such as interest rate, credit, liquidity, foreign exchange, and price volatility. Because of these possible risks associated with the equity, bond, and currency markets, it is reasonably possible that changes in the values of various investment positions could occur in the near term and that such changes could materially affect the amounts reported in the consolidated financial statements. To monitor the risk of the investment portfolio, Children's has investment policies in place and monitors the performance of all investments on a regular basis.

***(l) Pending Investment Settlements Receivable and Payable***

Purchases and sales of securities are reflected on a trade-date basis. A receivable or payable is recorded for the proceeds to be paid or collected as of the settlement date of the purchase or sale of the security.

***(m) Land, Buildings, and Equipment***

Land, buildings, and equipment are recorded at cost at the date of purchase or fair market value at the date of donation. Depreciation is provided on a straight-line basis over the estimated useful lives of the related assets, which range from 3 years for certain equipment to 40 years for buildings.

***(n) Deferred Financing Costs***

Deferred financing costs are amortized to financing costs over the term of the related bonds using the straight-line method, which approximates the effective-interest method.

***(o) MinnesotaCare Tax***

Children's pays a state tax on patient service revenue receipts other than Medicare receipts in order to fund medical care for the uninsured. The tax was 1.8% and 2.0% for the 12-month periods ended December 31, 2020 and 2019, respectively. Children's recognized $14,006 and $17,149 as MNCare tax in health services taxes expense on the consolidated statements of operations for the years ended December 31, 2020 and 2019, respectively.

***(p) Net Assets With Donor Restrictions***

Net assets with donor restrictions include those whose use at Children's has been limited by donors to a specific time period or purpose or have been restricted by donors to be maintained by Children's in perpetuity.

***(q) Donor-Restricted Gifts***

Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received. 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 accomplished, net assets with donor restrictions are reclassified as net assets without donor restrictions and reported in the consolidated statements of operations and changes in net assets as net assets released from restrictions. In the absence of donor specification that income and gains on donated funds are restricted, such income and gains are reported as income of net assets without donor restrictions. Children's accounts for net assets with donor restrictions where the time or purpose restriction has been satisfied during the year as net assets with donor restrictions released from restriction.

***(r) Community Benefits and Charity Care***

To further its purpose as a charitable organization, Children's provides a wide variety of benefits to the community. These services and donations account for a measurable portion of Children's costs and serve to promote healthy lifestyles, community development, health education, and affordable access to care. Included in these community benefits are the costs of charity care. Children's provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than established rates. Because Children's does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. The amount of charges forgone for services provided under Children's charity care policy was $2,648 and $6,141 for the years ended December 31, 2020 and 2019, respectively. Total direct and indirect costs related to these forgone charges were $1,073 and $2,420, respectively, based on an average ratio of cost to gross charges.

***(s) Other Revenue***

*COVID-19 Pandemic Funding*

On March 11, 2020, the World Health Organization designated COVID-19 as a global pandemic. Patient volumes and the related revenues for most services were significantly impacted in March through June and continue to be impacted. Various policies were implemented by federal, state, and local governments in response to the COVID-19 pandemic that have caused many people to remain at home and forced the closure of or limitations on certain businesses. Nonemergent surgical procedures by healthcare facilities were suspended for a period of time. While some of these restrictions have been eased across the U.S. and most states have lifted moratoriums on nonemergent procedures, some restrictions remain in place, and some state and local governments are reimposing certain restrictions. Patient volumes and revenues experienced gradual improvement beginning in June and continuing through the end of the fiscal year; however, volumes remain below those of the prior year.

On March 27, 2020, the Coronavirus Aid, Relief, and Economic Security (CARES) Act was enacted into law, which provided significant funding to healthcare providers and hospital systems. The funding is intended to compensate healthcare providers for lost revenues and incremental expenses incurred in response to the COVID-19 pandemic and is not required to be repaid provided the recipients attest to and comply with certain terms and conditions, including demonstrating that the distributions received have been used for healthcare-related expenses or lost revenue attributable to COVID-19. For the year ended December 31, 2020, Children’s received $40,236 in general and targeted Provider Relief Fund distributions, as provided for under the CARES Act. Of this amount, $19,188 were general fund distributions, and $21,048 were targeted distributions from the CARES Act Provide Relief Fund. In addition, Children’s received $9,781 in other federal and state funding as a result of other stimulus programs. Such payments are accounted for as government grants and are recognized on a systematic and rational basis as other income once there is reasonable assurance that the applicable terms and conditions required to retain the funds will be met.

Children’s has been and will continue to monitor compliance with the terms and conditions of all federal and state funding received. If Children’s is unable to attest to or comply with the current or future terms and conditions, the ability to retain some or all of the distributions received may be impacted.

The CARES Act also provides for deferred payment of the employer portion of social security taxes between March 2020 and December 31, 2020, with 50% of the deferred amount due by December 31, 2021 and the remaining 50% due by December 31, 2022. As of December 31, 2020, Children’s deferred $13,822 in social security taxes, $6,911 of which are included in accrued salaries, wages, and benefits and $6,911 of which are included in other long-term liabilities in the accompanying consolidated balance sheets. Additionally, the CARES Act provides for a payroll tax credit designed to encourage retention of employees during the pandemic. Children’s has evaluated its eligibility and related data for consideration of the employee retention tax credit and recorded $828 as other operating revenue. Children’s also recorded $4,889 in relief from the Emergency Unemployment Relief for Governmental Entities and Nonprofit Organization section of the CARES Act as other operating revenue.

In summary, all sources of COVID-19 funding yielded $50,017 in revenues recognized as other revenue in the accompanying consolidated statements of operations and changes in net assets for the year ended December 31, 2020.

*Other Operating Revenue*

Other revenue unrelated to COVID-19 funding sources primarily includes revenue from cafeterias, parking ramps, medical education, pharmacies, grants, and other miscellaneous sources. Revenue is recognized upon delivery of the service or the product.

***(t) Pledges Receivable***

Children’s records pledges receivable at the time an unconditional pledge agreement is signed. All pledges receivable are classified as net assets with donor restrictions based on the intent of the donor and represent pledges to be used primarily for program initiatives. Pledges due in more than one year are recorded at net present value of future cash flows, less an allowance for uncollectible pledges. A discount on each pledge is calculated using the risk-free interest rate at the time the pledge was made and for the duration of the pledge.

Pledges receivable at December 31, 2020 and 2019 were as follows:

| | | 2020 | 2019 |
|---|---|---|---|
| Pledges due: | | | |
| In less than one year | $ | 3,356 | 4,520 |
| In one to five years | | 2,513 | 3,947 |
| More than five years | | 3,421 | 3,613 |
| Total pledges due | | 9,290 | 12,080 |
| Less discount | | (1,090) | (1,220) |
| Less allowance for uncollectible pledges | | (533) | (412) |
| Pledges receivable – net | $ | 7,667 | 10,448 |
| Classified as: | | | |
| Prepaid expenses and other current assets | $ | 3,007 | 4,336 |
| Other assets | | 4,660 | 6,112 |
| Pledges receivable – net | $ | 7,667 | 10,448 |

### *(u) Concentration of Risk*

At December 31, 2020, Children's had 38.3% of its employee population covered under labor contracts. Of those employees, 24.1% are covered under labor contracts that expired the last day of March 2021, with negotiations underway to extend the contracts through February 2024. An additional 75.4% are covered under labor contracts that are set to expire on the last day of May 2022, and 0.5% are covered under labor contracts that are set to expire the last day of April 2023. Work stoppages in the course of contract negotiations are possible, which could lead to the disruption of normal operations. Any resulting disruption could have an adverse impact on operating costs and/or patient service revenue.

### *(v) Excess of Revenue over Expenses*

Children's consolidated results of operations include excess revenue over expenses. Consistent with industry practice, changes in net assets without donor restrictions that are excluded from excess revenue over expense include net assets released from restriction for capital acquisitions and pension plan–related changes, the nonservice component of pension expense. Investment gains and losses on investments without donor restrictions, income and losses from investments accounted for under the equity method, unrealized gains or losses on investments, and the change in fair value of interest rate swaps are included in excess of revenues over expenses. Transactions related to net assets with donor restrictions are recorded as additions or deductions to net assets with donor restrictions and reflected in the consolidated statements of operations and changes in net assets.

### (w) *Derivative Instruments and Hedging Activities*

From time to time, Children's makes use of certain exchange-traded options and futures contracts to manage its overall equity exposure, which is included in investments and recorded at fair value based on published market prices. Children's also makes use of interest rate swap agreements to hedge interest rate exposure on its variable rate debt. Interest rate swaps are recorded at fair value in the consolidated balance sheets representing the funds that would be paid or received if the swap agreements were terminated. Changes in the fair values are recorded as a component of nonoperating gains or losses in the consolidated statements of operations and changes in net assets. Fair value is determined based on the use of models that consider various assumptions, including present value of cash flows, yield curve structure, as well as other relevant economic measures, which are inputs that are classified as Level 2 in the valuation hierarchy (note 2). The net interest paid or received on interest rate swaps is recognized as financing costs in the consolidated statements of operations and changes in net assets.

### (x) *Liquidity and Availability*

As of December 31, 2020, Children's has working capital of $75,565 and average days cash on hand of 440. As of December 31, 2019, Children's has working capital of $89,403 and average days cash on hand of 334.

Financial assets available for general expenditure within one year of the consolidated balance sheet date consist of the following:

| | | 2020 | 2019 |
|---|---|---|---|
| Financial assets at year-end: | | | |
| Cash and cash equivalents | $ | 27,090 | 19,106 |
| Short-term investments | | 5,894 | 9,263 |
| Short-term investments, board-designated | | 84 | 133 |
| Patient accounts receivable | | 121,421 | 154,783 |
| Funds held by trustee | | 7 | 3,131 |
| Long-term investments | | 938,521 | 738,223 |
| Board-designated investments | | 123,331 | 117,638 |
| Total financial assets | | 1,216,348 | 1,042,277 |
| Less amounts not available to be used within one year: | | | |
| Funds held by trustee | | (7) | (3,131) |
| Long-term investments with certain contractual restrictions | | (219,350) | (186,041) |
| Long-term investments with donor restrictions | | (68,875) | (63,253) |
| Financial assets not available to be used within one year | | (288,232) | (252,425) |
| Financial assets available to meet general expenditures within one year | $ | 928,116 | 789,852 |

As part of Children’s liquidity management plan, cash in excess of daily requirements is invested in short-term investments and money market funds. Additionally, Children’s maintains a $60,000 line of credit with U.S. Bank. As of December 31, 2020 and 2019, no amounts were drawn on the line of credit.

As of December 31, 2020 and 2019, Children’s was in compliance with all financial covenants required by its bond insurer, as more fully described in note 4.

***(y) Leases***

Children’s follows ASC Topic 842, *Leases*, which requires lessees to recognize leases on the consolidated balance sheets and disclose key information about leasing arrangements. ASC Topic 842 establishes a right-of-use (ROU) model that requires a lessee to recognize a ROU asset and lease liability on the consolidated balance sheets for all leases with a term longer than 12 months. Leases are classified as financing or operating, with classification affecting the pattern and classification of the expense recognition in the consolidated statements of operations and changes in net assets. In applying the standard, Children’s elected to adopt the package of practical expedients, including not reassessing past lease accounting, not separating lease components from nonlease components, and not reassessing previously capitalized initial direct costs.

Children’s determines if an arrangement is or contains a lease at contract inception. Children’s recognizes a ROU asset and a lease liability at the lease commencement date if the lease period exceeds one year. Leases less than one year are expensed monthly as incurred.

For operating leases, the lease liability is initially and subsequently measured at the present value of the unpaid lease payments at the lease commencement date. For finance leases, the lease liability is initially measured in the same manner and date as for operating leases and is subsequently measured at amortized cost using the effective-interest method.

Key estimates and judgments include how Children’s determines (1) the discount rate it uses to discount the unpaid lease payments to present value, (2) lease term, and (3) lease payments.

ASC Topic 842 requires a lessee to discount its unpaid lease payments using the interest rate implicit in the lease or, if that rate cannot be readily determined, its incremental borrowing rate. Children’s uses its incremental borrowing rate as the discount rate for the leases.

The lease term for all of Children’s leases includes the noncancelable period of the lease plus any additional periods covered by either a Children’s option to extend (or not to terminate) the lease that Children’s is reasonably certain to exercise or an option to extend (or not to terminate) the lease controlled by the lessor.

Lease payments included in the measurement of the lease liability comprise the following:

- Fixed payments
- Variable lease payments that depend on an index or rate
- Amounts expected to be payable under a Children’s provided residual value guarantee

- The exercise price of a Children's option to purchase the underlying asset if Children's is reasonably certain to exercise the option.

The ROU asset is initially measured at cost, which comprises the initial amount of the lease liability adjusted for lease payments made at or before the lease commencement date, plus any initial direct costs incurred less any lease incentives received.

For operating leases, the ROU asset is subsequently measured throughout the lease term at the carrying amount of the lease liability, plus initial direct costs, plus (minus) any prepaid (accrued) lease payments, less the unamortized balance of lease incentives received. Lease expense for lease payments is recognized on a straight-line basis over the lease term.

Children's monitors for events or changes in circumstances that require a reassessment of one of its leases. When a reassessment results in the remeasurement of a lease liability, a corresponding adjustment is made to the carrying amount of the corresponding ROU asset unless doing so would reduce the carrying amount of the ROU asset to an amount less than $0. In that case, the amount of the adjustment that would result in a negative ROU asset balance is recorded in profit or loss.

Operating lease ROU assets are presented as operating lease ROU assets on the consolidated balance sheet. The current portion and long-term portion of operating lease liabilities are presented separately as operating lease liabilities on the consolidated balance sheet.

## (2) Financial Instruments, Risk Management Activities, and Fair Value

### *(a) Investments*

The market value of Children's marketable debt, equity securities, and other investible securities at December 31, 2020 and 2019 is shown below:

| | | 2020 | 2019 |
|---|---|---|---|
| Fixed income securities | $ | 295,526 | 162,771 |
| Corporate equities | | 118,524 | 117,926 |
| Foreign investments | | 193,019 | 140,095 |
| Investments measured at net asset value | | 455,133 | 442,869 |
| Perpetual trusts held by others | | 4,590 | 4,295 |
| Interest and dividends receivable | | 1,045 | 432 |
| Total | $ | 1,067,837 | 868,388 |

| | | 2020 | 2019 |
|---|---|---|---|
| Investments are reported as: | | | |
| Short-term investments | $ | 5,894 | 9,263 |
| Short-term investments, board-designated | | 84 | 133 |
| Funds held by trustee | | 7 | 3,131 |
| Long-term investments | | 938,521 | 738,223 |
| Board-designated investments | | 123,331 | 117,638 |
| Total | $ | 1,067,837 | 868,388 |

Classification of marketable securities as current or noncurrent is dependent on their availability for current operations. Availability for current operations is determined by management intention, investment maturity date, and liquidity.

As of December 31, 2020 and 2019, the following schedule summarizes the investment gains (losses) and its classification in the consolidated statements of operations and changes in net assets:

| | | 2020 | 2019 |
|---|---|---|---|
| Investment earnings in net assets without donor restrictions: | | | |
| Interest and dividend income | $ | 295 | 37,219 |
| Net realized gains (losses) on investments | | 15,445 | (3,252) |
| Net unrealized gains on investments | | 46,751 | 55,607 |
| Total | | 62,491 | 89,574 |
| Investment earnings in net assets with donor restrictions: | | | |
| Interest and dividend (losses) income | | (38) | 2,566 |
| Net realized gains (losses) on investments | | 514 | (461) |
| Net unrealized gains on investments | | 4,338 | 4,189 |
| Total | | 4,814 | 6,294 |
| Total investment gains | $ | 67,305 | 95,868 |
| Reported within: | | | |
| Other operating revenue | $ | 24 | 156 |
| Investment income and realized gains | | 15,716 | 33,811 |
| Net unrealized gains on investments | | 46,751 | 55,607 |
| Changes in net assets with donor restrictions | | 4,814 | 6,294 |
| Total investment gains | $ | 67,305 | 95,868 |

Children's periodically has investment strategies that use derivative instruments like swaps, swaptions, futures, and options contracts, which are within its investment policies. These derivative positions are not designated as hedges for accounting purposes. The changes in fair market value of these instruments are recorded as investment gains (losses) in the consolidated statements of operations and changes in net assets.

***(b) Risk Management***

Children's is exposed to interest rate risk with its variable rate debt structure. To manage these risks, Children's has entered into certain fixed payor swap agreements that hedge a portion of its variable interest rate risk. Generally, under these swaps, Children's agrees with a counterparty to exchange the difference between fixed-rate and floating-rate interest amounts based on notional principal amounts. Swap valuations are derived from the London InterBank Offered Rate (LIBOR) swap curve and fluctuate with directional or yield curve changes in that market.

***(c) Interest Rate Swaps***

At December 31, 2019, Children's had four fixed payer interest rate swap agreements with Piper Jaffrey Financial Products Inc., which hedged the variable interest rate exposure associated with certain variable rate debt. With the January 15, 2020 refinancing of the series 2004A and 2004B bonds, the associated swaps were terminated. Only the interest rate swaps associated with the Series 2020A Bond remain outstanding at December 31, 2020 (note 4).

Children's records changes in the fair values of the interest rate swaps as a component of nonoperating gains (losses) in the consolidated statements of operations and changes in net assets. Children's has elected to not apply hedge accounting to these swap agreements. The fair values of the interest rate swaps are included on the face of the consolidated balance sheets and were a liability of $25,251 and $25,883 as of December 31, 2020 and 2019, respectively. This liability would have to be paid if the swap agreements were terminated. The change in fair value of the interest rate swaps was $(5,206) and $(5,135) for the years ended December 31, 2020 and 2019, respectively. Children's recognized $2,669 and $2,688 as interest costs in financing costs expense related to these swap agreements for the years ended December 31, 2020 and 2019, respectively.

On October 23, 2020, Children's entered into amendments to the outstanding fixed payer interest rate swap agreements associated with the Series 2007A1 Bonds and Series 2007A2 Bonds that were redeemed on that date (note 4). Pursuant to these amendments, the financial guaranty contract issued by a bond insurer that guaranteed swap payments owed by Children's was terminated, and the swap agreement with the replacement swap counterparty was amended to require posting by Children's of cash collateral in specified amounts if the bond rating of Children's is downgraded below its current ratings of AA- from Standard & Poor's Ratings Group.

The notional amounts and interest rates of the interest rate swaps at December 31, 2020 and 2019 are as follows:

| Swap agreement | | Fair value | Change in fair value * | Cash paid in settlement * | Current notional amount | Rate paid | Rate received |
|---|---|---|---|---|---|---|---|
| As of December 31, 2020: | | | | | | | |
| 2004A | $ | — | (104) | (3,884) | — | N/A | N/A |
| 2004B | | — | (41) | (1,954) | — | N/A | N/A |
| 2007A1 (2020A) ** | | (12,623) | (2,530) | — | 42,275 | 3.518 % | 0.351 % |
| 2007A2 (2020A) ** | | (12,628) | (2,531) | — | 42,275 | 3.518 | 0.351 |
| | $ | (25,251) | (5,206) | (5,838) | 84,550 | | |
| As of December 31, 2019: | | | | | | | |
| 2004A | $ | (3,780) | (588) | — | 17,025 | 4.127 % | 1.578 % |
| 2004B | | (1,913) | 84 | — | 19,500 | 4.266 | 1.578 |
| 2007A1 | | (10,093) | (2,315) | — | 43,400 | 3.518 | 1.511 |
| 2007A2 | | (10,097) | (2,316) | — | 43,425 | 3.518 | 1.511 |
| | $ | (25,883) | (5,135) | — | 123,350 | | |

* The 2004A and 2004B series interest rate swaps were fully settled on January 15, 2020 as part of the issuance of the Series 2020 taxable bonds and the related refinancing of the Series 2004A and 2004B bonds.

** The 2007A1 and 2007A2 swaps remain outstanding following the refinancing of the 2007A bonds with the proceeds of the Series 2020A Bonds, and are identified as "qualified hedges" with respect to the Series 2020A Bonds.

Children's has credit risk in the event of nonperformance by the counterparty in the interest rate swap agreements.

### *(d) Fair Value of Financial Instruments*

The carrying values of cash and cash equivalents, patient accounts receivable, and accounts payable, and other accrued expenses approximate fair value due to their short-term nature. Marketable securities are carried at fair value. All other assets and liabilities that qualify as financial instruments under GAAP are carried at contractual amounts, which generally approximate fair value.

Children’s values its financial assets and liabilities in accordance with the accounting guidance that establishes a three-tier fair value hierarchy. Level 1 provides the most reliable measure of fair value while Level 3 generally requires significant management judgment. Considerable judgment may be required in interpreting market data used to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts that could be realized in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value. Three levels are defined as follows:

*Level 1* – Inputs represent unadjusted quoted prices for identical assets or liabilities exchanged in active markets.

*Level 2* – Inputs include directly or indirectly observable inputs other than Level 1 inputs, such as quoted prices for similar assets or liabilities exchanged in active or inactive markets, quoted prices for identical assets or liabilities exchanged in inactive markets, or other inputs that are considered in fair value determinations of assets or liabilities.

*Level 3* – Inputs include unobservable inputs used in the measurement of assets and liabilities. Management is required to use its own assumptions regarding unobservable inputs because there is little, if any, market activity in the assets or liabilities or related observable inputs that can be corroborated at the measurement date.



(Continued)

Financial assets and liabilities measured at fair value on a recurring basis at December 31, 2020 and 2019 are summarized in the following tables by type of inputs applicable to the fair value measurements:

| | | Fair value | | | |
|---|---|---|---|---|---|
| | | **Level 1** | **Level 2** | **Level 3** | **Total** |
| As of December 31, 2020: | | | | | |
| Cash and cash equivalents | $ | 27,090 | — | — | 27,090 |
| Investments: | | | | | |
| Fixed-income securities: | | | | | |
| Money market and short-term bond funds | | 1,703 | 27,846 | — | 29,549 |
| U.S. gov't and U.S. gov't agencies obligations | | — | 43,411 | — | 43,411 |
| Municipal bond fund | | 20 | — | — | 20 |
| Closed-end bond funds | | — | 110,260 | — | 110,260 |
| Mortgage-backed securities | | — | 8,369 | — | 8,369 |
| Asset-backed securities | | — | 2,239 | — | 2,239 |
| Investment grade corporate bond funds | | 61,153 | 36,297 | — | 97,450 |
| High yield bonds | | — | 4,228 | — | 4,228 |
| Total fixed-income securities | | 62,876 | 232,650 | — | 295,526 |
| Corporate equities: | | | | | |
| Large cap | | 14,615 | — | 60 | 14,675 |
| Mid cap | | 41,294 | — | — | 41,294 |
| Small cap | | 19,755 | — | — | 19,755 |
| Closed-end equity funds | | 38,222 | — | — | 38,222 |
| Master limited partnership | | — | 4,578 | — | 4,578 |
| Total corporate equities | | 113,886 | 4,578 | 60 | 118,524 |
| Foreign investments: | | | | | |
| Foreign bonds | | — | 20,594 | — | 20,594 |
| Foreign equities | | 172,425 | — | — | 172,425 |
| Total foreign investments | | 172,425 | 20,594 | — | 193,019 |
| Total investments measured at net asset value* | | | | | 455,133 |
| Perpetual trusts held by others | | — | 4,590 | — | 4,590 |
| Interest and dividends receivable | | 1,045 | — | — | 1,045 |
| Total investments | $ | 350,232 | 262,412 | 60 | 1,067,837 |
| Fair value of interest rate swaps liability | $ | — | 25,251 | — | 25,251 |
| Deferred compensation – other assets | $ | 7,889 | — | — | 7,889 |

| | Fair value | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| As of December 31, 2019: | | | | |
| Cash and cash equivalents | $ 19,106 | — | — | 19,106 |
| Investments: | | | | |
| Fixed-income securities: | | | | |
| Money market and short-term bond funds | 10,240 | 15,799 | — | 26,039 |
| Municipal bond fund | 19 | — | — | 19 |
| Closed-end bond funds | — | 86,002 | — | 86,002 |
| Mortgage-backed securities | — | 5 | — | 5 |
| Investment grade corporate bond funds | 43,125 | 7,581 | — | 50,706 |
| Total fixed-income securities | 53,384 | 109,387 | — | 162,771 |
| Corporate equities: | | | | |
| Large cap | 36 | — | 60 | 96 |
| Mid cap | 34,435 | — | — | 34,435 |
| Small cap | 24,042 | — | — | 24,042 |
| Closed-end equity funds | 54,162 | — | — | 54,162 |
| Equity futures options | 33 | — | — | 33 |
| Master limited partnership | — | 5,158 | — | 5,158 |
| Total corporate equities | 112,708 | 5,158 | 60 | 117,926 |
| Foreign investments: | | | | |
| Foreign bonds | — | 11,135 | — | 11,135 |
| Foreign equities | 128,960 | — | — | 128,960 |
| Total foreign investments | 128,960 | 11,135 | — | 140,095 |
| Total investments measured at net asset value* | | | | 442,869 |
| Perpetual trusts held by others | — | 4,295 | — | 4,295 |
| Interest and dividends receivable | 432 | — | — | 432 |
| Total investments | $ 295,484 | 129,975 | 60 | 868,388 |
| Fair value of interest rate swaps liability | $ — | 25,883 | — | 25,883 |
| Deferred compensation – other assets | $ 7,341 | — | — | 7,341 |

* Investments are measured at net asset value and included only for reconciliation purposes.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. Level 2 and Level 3 valuation methodologies are listed below.

For certain investments, Children's utilizes net asset value as a practical expedient to fair value. Investments measured at net asset value at December 31, 2020 and 2019 are summarized in the following tables:

| | Net asset value | Redemption frequency | Redemption notice | Unfunded commitments |
|---|---|---|---|---|
| As of December 31, 2020: | | | | |
| Commingled funds (a) | $ 67,216 | Monthly | Monthly | — |
| Limited partnerships (b) | | | | |
| Private credit | 58,428 | None | None | 55,846 |
| Private credit | 22,688 | Semi-annual | 90 days | — |
| Private credit | 17,763 | Within 12 months | None | 3,353 |
| Private credit | 131 | Within 18 months | None | 748 |
| Private equity | 127,115 | None | None | 34,800 |
| Private equity | 20,717 | Monthly (at discretion of Trust) | Within two business days of month-end of repurchase date | — |
| Multi-strategy mandate hedge fund (c) | 41,993 | Monthly | 10 Days | — |
| Multi-strategy mandate hedge fund (c) | 81,755 | Monthly | Monthly | — |
| Single-strategy mandate hedge fund (d) | 4,368 | Quarterly | Quarterly | 19,891 |
| Single-strategy mandate hedge fund (d) | 12,959 | Three-year lock, then quarterly | 90-day notice | — |
| | $ 455,133 | | | |

| | Net asset value | Redemption frequency | Redemption notice | Unfunded commitments |
|---|---|---|---|---|
| As of December 31, 2019: | | | | |
| Commingled funds (a) | $ 87,281 | Daily | 10 Days | — |
| Limited partnerships (b) | | | | |
| Private credit | 46,021 | None | None | 48,709 |
| Private credit | 499 | >18 months | None | — |
| Private credit | 21,693 | Within 12 months | None | 2,613 |
| Private equity | 111,015 | None | None | 35,729 |
| Private equity | 20,259 | Monthly (at discretion of Trust) | within two business days of month-end of repurchase date | — |
| Multi-strategy mandate hedge fund (c) | 39,046 | Monthly | 10 Days | — |
| Multi-strategy mandate hedge fund (c) | 840 | Quarterly | Quarterly in advance | — |
| Multi-strategy mandate hedge fund (c) | 96,764 | Monthly | Monthly | — |
| Single-strategy mandate hedge fund (d) | 11,204 | Quarterly | Quarterly | 13,405 |
| Single-strategy mandate hedge fund (d) | 8,247 | Three-year lock, then quarterly | 90-day notice | — |
| | $ 442,869 | | | |

(a) Commingled fund investments – This category includes investments in portfolios that may not be sold to investors other than "accredited investors" within the meaning of Regulation D under the Securities Act of 1933 (Securities Act), unless sold pursuant to another available exemption from the Securities Act. The price of these funds' shares is based on the portfolio's net asset value. The net asset value is determined by dividing the total value of the portfolio's investments and other assets, less any liabilities, by the total number of shares outstanding. For purposes of calculating net asset value, portfolio securities and other assets for which market quotes are readily available are valued at market value. Market value is generally determined on the basis of official closing prices or the last reported sales prices, or if no sales are reported, based on quotes obtained from quotation reporting systems, established market makers, or pricing services.

(b) Limited partnership investments – This category includes investments in private market funds, generally through limited partnerships, that invest in private companies, private debt, intellectual property, structured products, and special situations. The fair value of these investments has been estimated using the percentage share of ownership interest in partner's capital. Distributions from each fund are received when the underlying investments in the funds create distributable cash flow and when underlying investments are liquidated. It is estimated that the underlying assets of these funds will be liquidated over the next 1 to 15 years.

(c) Multi-strategy mandate hedge funds – This category includes limited partnerships with monthly or quarterly liquidity that have broad investment mandates across geographic, public and private markets, and equity or fixed income markets.

(d) Single-strategy mandate hedge funds – This category includes limited partnerships with quarterly liquidity that have a specific strategy within a specific market.

Children's made no level transfers during 2020 or 2019.

## (3) Land, Buildings, and Equipment

Land, buildings, and equipment at December 31, 2020 and 2019 consisted of the following:

| | | 2020 | 2019 |
|---|---|---|---|
| Land | $ | 18,766 | 13,999 |
| Buildings and building improvements | | 489,497 | 484,301 |
| Furniture, fixtures, and equipment | | 357,974 | 346,634 |
| Construction in progress | | 1,320 | 117 |
| Land, buildings, and equipment – gross | | 867,557 | 845,051 |
| Less accumulated depreciation | | (559,531) | (516,891) |
| Land, buildings, and equipment – net | $ | 308,026 | 328,160 |

The construction in progress at December 31, 2020 relates to leasehold improvements and various equipment that has been received but not yet put into service. The construction in progress at December 31, 2019 relates to various equipment that had been received but not yet put into service.

There was no interest capitalized on construction for the years ended December 31, 2020 or 2019.

Depreciation expense for the years ended December 31, 2020 and 2019 was $46,369 and $44,011, respectively.

## (4) Long-Term Debt

Long-term debt at December 31, 2020 and 2019 consisted of the following:

| | | 2020 | 2019 |
|---|---|---|---|
| Health Care Revenue Bonds, Series 1995B (remarketed), remaining fixed interest rate range from 4.0% to 5.0%, due in installments through August 15, 2025 * | $ | — | 10,000 |
| Health Care Revenue Bonds, Series 2004A, interest rate at a variable rate, due through August 15, 2034 * (average of 1.195% for 2019) | | — | 17,025 |
| Health Care Revenue Bonds, Series 2004A-1 (remarketed), remaining fixed interest rate range from 3.0% to 5.0%, due in installments through August 15, 2034 * | | — | 15,850 |
| Health Care Revenue Bonds, Series 2004B, interest rate at a variable rate, due through August 15, 2025 * (average of 1.228% for 2019) | | — | 19,500 |
| Health Care Revenue Bonds, Series 2007A, interest rate at a variable rate, due through August 15, 2037 ** (average of 1.195% for 2019) | | — | 86,825 |
| Health Care Revenue Bonds, Series 2010A, remaining fixed interest rate range from 4.0% to 5.25%, due in installments through August 15, 2035 * | | — | 26,295 |
| Series 2020 taxable bonds, fixed interest rate of 3.448%, due in installments through August 15, 2049 | | 214,095 | — |
| Health Care Revenue Bond, Series 2020A, interest rate at a variable rate, due through August 15, 2037 ** (average of 0.735% for 2020) | | 84,560 | — |
| Total long-term debt | | 298,655 | 175,495 |
| Less: | | | |
| Unamortized bond premiums and discounts | | (1,306) | (317) |
| Unamortized bond issuance costs | | (2,832) | (2,440) |
| Current maturities | | (2,113) | (9,657) |
| Long-term portion | $ | 292,404 | 163,081 |

* Related bonds were refinanced as part of the Series 2020 taxable bond issuance on January 15, 2020.

** Series 2007A bonds were refinanced as part of Series 2020A tax-exempt bond issuance on October 23, 2020.

On January 15, 2020, Children's issued $214,095 of Taxable Bonds, Series 2020 (Series 2020 Bonds), due August 15, 2049, bearing a fixed interest rate of 3.448%. The proceeds of the Series 2020 Bonds were applied, in part, to refund the following outstanding bonds issued by the City of Minneapolis, Minnesota and the Housing and Redevelopment Authority of the City of St. Paul, acting jointly: (i) $10,000 outstanding aggregate principal amount of Health Care Revenue Bonds (Children's Health Care), Series 1995B; (ii) $17,025 outstanding aggregate principal amount of Variable Rate Revenue Bonds (Children's Hospitals and Clinics), Series 2004A; (iii) $15,850 outstanding aggregate principal amount of Health Care Facilities Revenue Bonds (Children's Hospitals and Clinics), Series 2004A-1; (iv) $19,500 outstanding aggregate principal amount of Variable Rate Revenue Bonds (Children's Hospitals and Clinics), Series 2004B; and (v) $26,295 outstanding aggregate principal amount of Health Care Facilities Revenue Bonds (Children's Health Care), Series 2010A. A remaining balance of approximately $125,425 was made available for strategic investments and other general corporate purposes, including payment of costs of issuance of the Series 2020 Bonds and the cost of retiring the fixed payor swap arrangements related to the Series 2004A and B Bonds.

On October 23, 2020, the City of Minneapolis and the Housing and Redevelopment Authority of the City of Saint Paul jointly issued an $84,560 million Health Care Facilities Variable Rate Revenue Refunding Bond (Children's Health Care), Series 2020A pursuant to an Indenture of Trust, dated as of October 1, 2020, between the Issuer and U.S. Bank National Association, as trustee (the Indenture). The proceeds of the Series 2020A Bonds are subject to a Loan Agreement, dated as of October 1, 2020, between the Issuer and Children's, with the proceeds applied to redeem in full the Issuer's Health Care Facilities Revenue Bonds (Children's Hospitals and Clinics of Minnesota), Series 2007A. The Series 2020A Bonds were issued in a private placement transaction to Old National Bank, a national banking association, and are a tax-exempt obligation. The 2020A Bonds are secured by a security interest in the unrestricted receivables of the Obligated Group, as defined under the Master Trust Indenture. The Series 2020A Bonds require amortization of principal on the same terms as applied to the Series 2007A Bonds. The Series 2020A Bonds bear interest at a variable rate based on one-month LIBOR and are subject to mandatory purchase on October 23, 2025. The Series 2020A Bonds are subject to optional redemption in whole or, with the consent of the holder, in part, upon election by Children's at a price of par plus interest accrued to the date of repayment.

As part of the refinancing and defeasance of the prior debt, Children's recognized a loss related to the write-off of the deferred financing costs on such debt in the amount of $2,357, which is included in depreciation and amortization and financing costs within the consolidated statements of operations and changes in net assets.

The series 2020 bonds were issued taxable bonds. The Series 2020A bonds were issued through the conduit organizations of the City of Minneapolis, Minnesota and the Housing and Redevelopment Authority of the City of Saint Paul, Minnesota on behalf of the Obligated Group, pursuant to the Master Trust Indenture. The bonds are secured by a security interest in the unrestricted receivables of the Obligated Group as defined under the Master Trust Indenture.

The redemption of the Series 2007A bonds and termination of Assured Guaranty's insurance policy supporting the related swap obligations resulted in the elimination of certain financial covenants required by the bond insurer. The Obligated Group was in compliance with all covenants at December 31, 2020 and 2019.



(Continued)

Currently, interest rates are set daily on the Series 2020A Bonds by remarketing agents. Holders of the bonds have the option to tender the bonds for repurchase. The remarketing agent has agreed to remarket the bonds tendered for purchase upon the conditions in the manner and at the times specified in the indentures related to such bond series.

Under the Master Trust Indenture and related agreements for each bond series, the Obligated Group maintains with a trustee a bond interest fund and a bond principal fund, the aggregated balances of which as of December 31, 2020 and 2019, were as follows:

| | 2020 | 2019 |
|---|---|---|
| Bond interest fund | $ 6 | 1,055 |
| Bond principal fund | 1 | 2,076 |
| Funds held by trustee | $ 7 | 3,131 |

The funds are available to meet debt service.

Aggregate annual maturities of long-term debt for each of the five years as of December 31, 2020 and thereafter are as follows:

| | |
|---|---|
| Year ending December 31: | |
| 2021 | $ 2,200 |
| 2022 | 2,385 |
| 2023 | 2,375 |
| 2024 | 2,400 |
| 2025 | 2,625 |
| Thereafter | 286,670 |
| Total | $ 298,655 |

## (5) Net Assets With Donor Restrictions

Net assets with donor restrictions are restricted for the following purposes and/or periods at December 31, 2020 and 2019:

| | | 2020 | 2019 |
|---|---|---|---|
| Donor-restricted endowments subject to spending policy and appropriation to support the following purposes: | | | |
| Program activities | $ | 29,347 | 26,298 |
| Health education and research | | 20,213 | 20,128 |
| Community service | | 3,580 | 3,404 |
| | | 53,140 | 49,830 |
| Perpetual trusts, distributions available to support the following purposes: | | | |
| Program activities | | 2,603 | 2,447 |
| Health education and research | | 1,987 | 1,848 |
| | | 4,590 | 4,295 |
| Subject to expenditure for specified purpose: | | | |
| Program activities | | 11,218 | 12,786 |
| Purchases of buildings and equipment | | 4,207 | 4,044 |
| Health education and research | | 2,289 | 1,671 |
| Community service | | 1,704 | 1,573 |
| Total | | 19,418 | 20,074 |
| Total net assets with donor restrictions | $ | 77,148 | 74,199 |

Children's governing board has designated net assets without donor restrictions for the following purposes:

| | | 2020 | 2019 |
|---|---|---|---|
| Quasi-endowment, subject to spending policy and appropriation to support the following purposes: | | | |
| Program activities | $ | 123,415 | 117,771 |
| | $ | 123,415 | 117,771 |

Net assets released from restrictions used for operations are included in other unrestricted revenue in the consolidated statements of operations and changes in net assets. Net assets as of December 31, 2020 and 2019 were released from donor restrictions by incurring expenses or by making capital expenditures satisfying the restricted purposes of the following:

| | | 2020 | 2019 |
|---|---|---|---|
| Department uses | $ | 4,793 | 7,256 |
| Purchases of buildings and equipment | | — | 1,165 |
| Health education and research | | — | 1,848 |
| Community service | | 1,550 | 1,786 |
| Total | $ | 6,343 | 12,055 |

***(a) Interpretation of Relevant Law***

Children's has interpreted 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 classifies as permanently restricted net assets (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 in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by Children's in a manner consistent with donor intent and the standard of prudence prescribed by UPMIFA.

| | | Without donor restrictions | With donor restrictions | Total |
|---|---|---|---|---|
| Year ended December 31, 2020: | | | | |
| Endowment net assets – beginning of year | $ | 117,771 | 54,125 | 171,896 |
| Investment returns: | | | | |
| Investment gains | | 1,314 | 654 | 1,968 |
| Net unrealized gains | | 8,866 | 3,865 | 12,731 |
| Change in value of perpetual trusts held by others | | — | 295 | 295 |
| Total investment returns | | 10,180 | 4,814 | 14,994 |

| | | Without donor restrictions | With donor restrictions | Total |
|---|---|---|---|---|
| Contributions | $ | — | 236 | 236 |
| Appropriations of endowment assets for expenditure | | (4,536) | (1,445) | (5,981) |
| Endowment net assets – end of year | $ | 123,415 | 57,730 | 181,145 |

| | | Without donor restrictions | With donor restrictions | Total |
|---|---|---|---|---|
| Year ended December 31, 2019: | | | | |
| Endowment net assets – beginning of year | $ | 108,031 | 46,934 | 154,965 |
| Investment returns: | | | | |
| Investment gains (losses) | | 5,801 | 2,283 | 8,084 |
| Net unrealized (losses) gains | | 8,435 | 3,541 | 11,976 |
| Change in value of perpetual trusts held by others | | — | 470 | 470 |
| Total investment returns | | 14,236 | 6,294 | 20,530 |
| Contributions | | — | 2,538 | 2,538 |
| Appropriations of endowment assets for expenditure | | (4,496) | (1,641) | (6,137) |
| Endowment net assets – end of year | $ | 117,771 | 54,125 | 171,896 |

### *(b) Funds with Deficiencies*

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or accounting guidance requires Children's to retain as a fund of perpetual duration. Deficiencies of this nature are funded by unrestricted net assets until the fair value of the assets returns to the required perpetual level. There were no deficiencies as of December 31, 2020 and 2019.

***(c) Return Objectives and Risk Parameters***

Children's has adopted investment and spending policies for endowment assets that attempt to provide a stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the organization must hold in perpetuity or for a donor-specified period, as well as board-designated funds. In the current investment environment, Children's expects its endowment funds to provide an annualized rate of return greater than its spending rate. Actual returns in any given year may vary from this amount. In 2020 and 2019, the spending rate was 4% for both donor-restricted and board-designated funds.

***(d) Strategies Employed for Achieving Objectives***

To satisfy its rate-of-return objectives, Children's relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current income (interest and dividends).

***(e) Spending Policy and how the Investment Objectives Relate to Spending Policy***

Children's has a policy of appropriating the spending rate times the fund's three-year average balance in accordance with donor intent and restrictions. The endowment corpus is to be maintained in perpetuity. Certain donor-restricted endowments require a portion of annual earnings to be maintained in perpetuity along with the corpus.

**(6) Insurance**

Children's has a wholly owned subsidiary, CHIN, which handles professional liability claims. CHIN is domiciled in the Cayman Islands. CHIN is funded through Children's operations. Premiums paid to the captive for the professional liability coverage during 2020 and 2019 were $5,620 and $4,716, respectively. CHIN insures Children's for hospital professional liability for $2,000 (2019: $1,000) for each claim and $6,000 (2019: $4,000) in the annual aggregate. In addition, Children's has purchased excess professional liability insurance for claims above the respective limits from commercial carriers in the amount of $35 million.

The consolidated financial statements of Children's include the investments held for professional liability claims, claims payments, and estimated professional liability reserves. The liability for losses and loss adjustment expenses (undiscounted) of $4,501 and $3,747 at December 31, 2020 and 2019, respectively, includes an amount determined from loss reports and individual cases and an amount, based on past experience and an actuarial report, for further development of reported losses. These estimates are continually reviewed and are subject to the impact of future changes in such factors as claim severity and frequency. Although management has made its best estimate of the liability for losses and loss adjustment expenses using the available information, ultimate settlement could vary significantly from such liability. Any adjustments to recorded liabilities will be reflected in the periods in which they become known.

Children's is self-insured for medical, dental, and workers' compensation claims and has recorded a liability for the estimated cost of claims incurred in accounts payable and accrued liabilities in the consolidated balance sheets. CHIN insures Children's for medical liability for individual claims between $250,000 and $800,000. Children's has purchased excess medical liability insurance for individual claims in excess of $800,000.

## (7) Employee Benefit Plans

Children's has noncontract and various union-sponsored pension or retirement plans covering substantially all employees.

### *(a) Pension Plan*

The Children's Health Care RSVP Retirement Plan (the Legacy Plan) was terminated on October 31, 2018. The Legacy Plan provided benefits to eligible noncontract employees based on final average salary and accumulated pension credits, which, in turn, were based on years of service. Benefit accruals under the Legacy Plan have been frozen since January 1, 2013.

A new plan was established, effective October 30, 2018, to assume Children's obligations under the Legacy Plan for certain specified participants. The new plan is called the Children's RSVP Retirement Plan II (the RSVP Plan II) and provides essentially the same benefits as were provided under the Legacy Plan to the individuals designated to participate in it. Children's determined who was eligible to participate in the RSVP Plan II based on certain criteria that it had established, including participant preference. The plan assets and liabilities of the individuals designated to participate in the RSVP Plan II have been transferred to the RSVP Plan II and are administered according to the terms of that plan.

In connection with the termination of the Legacy Plan, its assets were dispersed to participants as required by the plan document and applicable law. Accordingly, the accounts of participants under the terminating Legacy Plan were distributed to participants in that plan in the form of a lump-sum payment (subject to applicable rollover and distribution rules) or an annuity.

Total plan settlements were $1,664 and $3,752 for the years ended December 31, 2020 and 2019, respectively, which exceeded the aggregate of the plan's service and interest costs requiring the application of settlement accounting. Under settlement accounting, Children's recognized a loss of $344 and $717 for the years ended December 31, 2020 and 2019, respectively, which is included in nonservice component of pension expense within the consolidated statements of operations and changes in net assets.

The information for the defined-benefit pension plan as of and for the years ended December 31, 2020 and 2019 is as follows:

| | | RSVP II Plan 2020 | RSVP Plan 2019 | RSVP II Plan 2019 |
|---|---|---|---|---|
| Change in benefit obligation: | | | | |
| Obligation – beginning of year | $ | 31,753 | 1,059 | 32,868 |
| Interest cost | | 972 | — | 1,273 |
| Plan settlements | | (1,664) | (1,020) | (2,732) |
| Actuarial (gain) loss | | 1,863 | (15) | 990 |
| Benefit payments | | (649) | (24) | (646) |
| Obligation – end of year | $ | 32,275 | — | 31,753 |



(Continued)

| | RSVP II Plan 2020 | RSVP Plan 2019 | RSVP II Plan 2019 |
|---|---|---|---|
| Change in plan assets: | | | |
| Fair value of plan assets – beginning of year | $ 31,469 | 886 | 31,149 |
| Employer contributions | — | 200 | 2,300 |
| Plan settlements | (1,664) | (1,020) | (2,732) |
| Benefit payments | (649) | (24) | (646) |
| Actual return on plan assets | 1,711 | (42) | 1,398 |
| Fair value of plan assets – end of year | 30,867 | — | 31,469 |
| Net amount recognized: | | | |
| Current portion (included in accrued salaries, wages, and benefits) | — | — | — |
| Long-term portion (included in other long-term liabilities) | (1,408) | — | (284) |
| Funded status – end of year | (1,408) | — | (284) |
| Accumulated benefit obligation | $ 32,275 | — | 31,753 |

Components of net periodic benefit cost for the plan for 2020 and 2019 are as follows:

| | RSVP II Plan 2020 | RSVP Plan 2019 | RSVP II Plan 2019 |
|---|---|---|---|
| Interest cost | $ 972 | — | 1,273 |
| Expected return on plan assets | (886) | — | (904) |
| Settlement loss | 344 | 231 | 486 |
| Amortization of loss | 58 | — | 34 |
| Net periodic pension cost | $ 488 | 231 | 889 |

Components of RSVP plan related changes other than net periodic plan expense for 2020 and 2019 are as follows:

| | | RSVP II Plan 2020 | RSVP Plan 2019 | RSVP II Plan 2019 |
|---|---|---|---|---|
| Net (loss) gain arising during year | $ | (1,038) | (27) | (497) |
| Amortization of loss | | 402 | 231 | 521 |
| Total | $ | (636) | 204 | 24 |

Amount recognized in net assets without donor restrictions but not yet recognized as a component of net periodic benefit cost for the plan at December 31, 2020 and 2019 is as follows:

| | | RSVP II Plan 2020 | RSVP Plan 2019 | RSVP II Plan 2019 |
|---|---|---|---|---|
| Amortization of loss | $ | (5,969) | — | (5,333) |

Weighted average assumptions used to determine the benefit obligations and net periodic benefit costs at December 31, 2020 and 2019 are as follows:

| | RSVP II Plan 2020 | RSVP Plan 2019 | RSVP II Plan 2019 |
|---|---|---|---|
| Discount rate – benefit obligation | 2.39% | N/A | 3.29% |
| Discount rate – net periodic benefit cost | 3.29 | N/A | 4.28 |
| Rate of compensation increase | N/A | N/A | N/A |
| Expected return on plan assets | 3.00 | N/A | 3.00 |

Children's pension plan asset allocation at December 31, 2020 and 2019 by asset category is as follows:

| | Plan assets | |
|---|---|---|
| | 2020 | 2019 |
| Cash and cash equivalents | 1 % | 10 % |
| Fixed income investments | 99 | 90 |
| Total | 100 % | 100 % |

The pension plan's target asset allocation is approximately 100% fixed income.

Children's pension plan investments measured at fair value on a recurring basis at December 31, 2020 and 2019 are summarized in the following tables by type of inputs applicable to the fair value measurements of the RSVP and RSVP II Plans:

| | | Fair value | | |
|---|---|---|---|---|
| | | **Level 1** | **Level 2** | **Total** |
| December 31, 2020: | | | | |
| Cash, cash equivalents, and accrued interest | $ | 426 | — | 426 |
| Fixed income investments: | | | | |
| Investment grade | | — | 12,697 | 12,697 |
| Mortgage-backed securities | | — | 6,696 | 6,696 |
| Asset-backed securities | | — | 980 | 980 |
| Closed-end bond funds | | — | 5,108 | 5,108 |
| U.S. government agency and municipal issues | | — | 4,960 | 4,960 |
| Total fixed income investments | | — | 30,441 | 30,441 |
| Total pension plan investments | $ | 426 | 30,441 | 30,867 |

| | | Fair value | | |
|---|---|---|---|---|
| | | **Level 1** | **Level 2** | **Total** |
| December 31, 2019: | | | | |
| Cash, cash equivalents, and accrued interest | $ | 3,207 | — | 3,207 |
| Fixed income investments: | | | | |
| Investment grade | | — | — | — |
| U.S. government agency and municipal issues | | — | 28,262 | 28,262 |
| Total fixed income investments | | — | 28,262 | 28,262 |
| Total pension plan investments | $ | 3,207 | 28,262 | 31,469 |

See note 2 for discussion over the fair value hierarchy, fair value inputs, and valuation methodologies used at December 31, 2020 and 2019.

Children's made no transfers between levels during 2020 or 2019.

Benefits expected to be paid through the defined-benefit pension plans, by year, as of December 31, 2020 are as follows:

| | | |
|---|---|---|
| 2021 | $ | 2,804 |
| 2022 | | 2,228 |
| 2023 | | 2,144 |
| 2024 | | 2,094 |
| 2025 | | 1,896 |
| Subsequent five years | | 7,878 |

Children's does not expect to make a contribution to the RSVP II Plan during 2021. The estimated net actuarial loss for the plan that will be amortized from unrestricted net assets into net periodic benefit cost during 2021 is $104.

The long-term rate of return on assets reflected in the 2020 expense was 3.0%. The rate is determined based on Children's asset allocation during 2020 of 1.0% cash and cash equivalents and 99.0% fixed income and an actuarial model that analyzes historical returns and projects a range of future annual returns. Annually, management reviews the actual long-term rate of return on assets, compares this return with the actuarial model of expected returns, and adjusts accordingly.

***(b) Multiemployer Plans***

Children's contributes to various union-sponsored multiemployer pension plans under the terms of collective bargaining agreements. These contributions are determined in accordance with the provisions of negotiated labor contracts and generally are based on salary and the number of hours worked. The risks of participating in these multiemployer plans are different from single-employer plans in the following aspects:

a. Assets contributed to the multiemployer plan by one employer may be used to provide benefits to employees of other participating employers.

b. If a participating employer stops contributing to the plan, the unfunded obligations of the plan may be borne by the remaining participating employers.

c. If Children's chooses to stop participating in some of its multiemployer plans, Children's may be required to pay those plans an amount based on the underfunded status of the plan, referred to as a withdrawal liability.

Children's participation in these plans for the year ended December 31, 2020 is outlined in the table below. The "EIN/Pension Plan Number" column provides the Employee Identification Number (EIN) and the three-digit plan number. The zone status is based on information that Children's received from the plan and is certified by the plan's actuary. Among other factors, plans in the red zone are generally less than 65% funded, plans in the yellow zone are less than 80% funded, and plans in the green zone are at least 80% funded. The "FIP/RP Status Pending/Implemented" column indicates plans for which a financial improvement plan (FIP) or a rehabilitation plan (RP) is either pending or has been implemented. The last column lists the expiration date of the collective bargaining agreement to which the plans are subject. There have been no significant changes that affect the comparability of 2020 and 2019 contributions.

| Pension fund | EIN/ Pension plan number | Pension protection act zone status (a) January 1 2020 | Pension protection act zone status (a) January 1 2019 | FIP/RP status pending/ implemented | Contributions of Children's Plan year ended 2020 | Contributions of Children's Plan year ended 2019 | Surcharge imposed | Expiration date of collective bargaining agreement |
|---|---|---|---|---|---|---|---|---|
| Twin City Hospitals – Minnesota Nurses Association Pension Plan | 41-6184922/001 | Green | Green | Implemented | $ 14,091 | 11,996 | No | 5/31/2022 |
| Other funds | — | — | — | — | 661 | 663 | — | — |
| Total contributions | | | | | $ 14,752 | 12,659 | | |

(a) The plan's funding level on January 1, 2020 is determined based on the actual December 31, 2019 asset values and projected liabilities as of January 1, 2020 that are a rollforward of liabilities from the previous valuation date of January 1, 2019, assuming no actuarial gains/losses occur during the period.

In January 2021, Children's contributed $15,071 to the Twin City Hospitals – Minnesota Nurses Association Pension Plan, which is Children's proportionate share of the minimum 2021 contribution requirement according to the collective bargaining agreement. Children's does not expect to make an additional contribution during 2021.

Children's was listed in the Twin City Hospitals Minnesota Nurses Association Pension Plan Form 5500 as providing more than 5% of the total contributions for the plan years ended December 31, 2020 and 2019. At the date the consolidated financial statements were issued, the Form 5500 was not available for the plan year ended in 2020.

### *(c) Postretirement Healthcare Plan*

Children's extends health insurance coverage to nurses covered by the Minnesota Nurses Association labor contract who elect to retire and begin receiving pension benefits at age 55 or older. The postretirement healthcare benefit plans are unfunded. The accumulated postretirement benefit obligation and the amounts recognized in the consolidated financial statements as of and for the years ended December 31, 2020 and 2019 are as follows:

| | | 2020 | 2019 |
|---|---|---|---|
| Change in benefit obligations: | | | |
| Obligation – beginning of year | $ | 3,122 | 2,530 |
| Service cost | | 151 | 98 |
| Interest cost | | 100 | 106 |
| Net loss (gain) | | 560 | 538 |
| Benefit payments | | (181) | (150) |
| Obligation included in other long-term liabilities – end of year | $ | 3,752 | 3,122 |

For the 2020 postretirement benefit obligation, certain actuarial assumptions were changed from 2019, including the discount rate, mortality assumptions, retirement rates, and termination rates. Children's recognizes these gains and losses in the year the assumptions are changed.

The discount rate used in determining the accrued postretirement liability was 2.4% for 2020 and 3.2% for 2019. For measurement purposes, a 6.5% annual rate increase in the cost of covered healthcare benefits was assumed for 2020; the rate was assumed to decrease by 0.5% per year for three years beginning in 2023, reaching 5.0% in 2025 and thereafter. Healthcare cost trend rates would affect the accrued postretirement obligation and the sum of service cost and interest cost as follows:

| | | 1% Increase | 1% Decrease |
|---|---|---|---|
| Accrued postretirement benefit liability | $ | 557 | (467) |
| Sum of service cost and interest cost | | 48 | (39) |

### *(d) Defined-Contribution Plan*

Children's has a defined-contribution plan, covering substantially all employees. Effective January 1, 2018, Children's adopted an IRS Safe Harbor plan whereby all employer contribution match is vested immediately. Deferral adjustments are a participant-directed activity. The amount expensed to the consolidated statements of operations and changes in net assets was $14,949 and $15,248 for the 12 months ended December 31, 2020 and 2019, respectively.

### *(e) Deferred Compensation Plans*

Children's also maintains other nonqualified deferred compensation plans to provide supplemental retirement benefits for executive management and employed physicians. As of December 31, 2020, there were 15 executives and 165 employed physicians active in the plan. The liability for these plans at December 31, 2020 and 2019 was $7,889 and $7,341, respectively, of which $5,489 and $4,785 was included in other long-term liabilities and $2,401 and $2,556 was included in accrued salaries, wages, and benefits in the consolidated balance sheets.

## (8) Functional Expenses

Children's provides general healthcare services to residents primarily within its geographic location. Expenses related to providing these services included in the consolidated statements of operations and changes in net assets for the years ended December 31, 2020 and 2019 are as follows:

| | Year ended December 31, 2020 | | | |
|---|---|---|---|---|
| | **Program** | **G&A** | **Fundraising** | **Total** |
| Salaries, wages, and employee benefits | $ 446,022 | 70,189 | 2,830 | 519,041 |
| Professional fees and purchased services | 88,389 | 30,882 | 793 | 120,064 |
| Supplies | 100,349 | 909 | 10 | 101,268 |
| Facilities | 15,943 | 1,626 | — | 17,569 |
| Depreciation and amortization | 40,576 | 9,970 | 100 | 50,646 |
| Financing costs | 10,496 | — | — | 10,496 |
| Health services taxes | 25,677 | 5 | 1 | 25,683 |
| Other | 43,112 | 11,749 | 4,397 | 59,258 |
| Total expenses | $ 770,564 | 125,330 | 8,131 | 904,025 |

| | Year ended December 31, 2019 | | | |
|---|---|---|---|---|
| | **Program** | **G&A** | **Fundraising** | **Total** |
| Salaries, wages, and employee benefits | $ 480,759 | 70,063 | 3,169 | 553,991 |
| Professional fees and purchased services | 97,973 | 30,664 | 1,099 | 129,736 |
| Supplies | 106,312 | 908 | 48 | 107,268 |
| Facilities | 15,631 | 1,626 | — | 17,257 |
| Depreciation and amortization | 34,939 | 9,949 | 102 | 44,990 |
| Financing costs | 7,586 | — | — | 7,586 |
| Health services taxes | 28,308 | — | 9 | 28,317 |
| Other | 36,321 | 13,023 | 5,151 | 54,495 |
| Total expenses | $ 807,829 | 126,233 | 9,578 | 943,640 |

## (9) Income Taxes

The IRS has determined that Children's and its subsidiaries, except for CHN and CHME, which are taxable not-for-profit corporations under the Minnesota Not-for-profit Corporations Act, are exempt organizations as described in Section 501(c)(3) of the Internal Revenue Code. For those tax-exempt organizations, Children's believes that it continues to meet the requirements of the IRC to sustain its tax-exempt status. In accordance with ASC Subtopic 740-10, *Income Taxes – Overall*, Children's recognizes the effect of income tax positions only if those positions are more likely than not of being sustained. Recognized income tax positions are measured at the largest amount that is greater than 50% likely of being realized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs. Management determined there were no material income tax positions for the years ended December 31, 2020 or 2019. Children's is not subject to an income tax examination for years before 2016.

## (10) Other Assets

Other assets for the years ended December 31, 2020 and 2019 consist of the following:

| | | 2020 | 2019 |
|---|---|---|---|
| Investments in unconsolidated joint ventures | $ | 51,293 | 46,631 |
| Deferred compensation | | 7,889 | 7,341 |
| Foundation long-term pledges receivable – restricted | | 4,660 | 6,112 |
| Other | | 15,995 | 16,564 |
| Total other assets | $ | 79,837 | 76,648 |

Investments held under deferred compensation arrangements are considered Level 1 investments. Children's uses the equity method of accounting for joint ventures or investments in which Children's has determined that it has significant influence. The following table represents Children's investment in and share of net earnings of unconsolidated entities recorded under the equity method of accounting as of and for the years ended December 31:

| | Percentage | Equity investment | | Share of net earnings (loss) | |
|---|---|---|---|---|---|
| | ownership | 2020 | 2019 | 2020 | 2019 |
| HealthEast Woodwinds Hospital Diagnostic Treatment Center | 20 % | 10,499 | 10,299 | 1,394 | 3,352 |
| Critical Care Services, Inc. (d/b/a Life Link III) | 10 | 4,527 | 4,204 | 323 | 509 |
| Health System Cooperative Laundries | 6 | 667 | 749 | (82) | 4 |
| Mother Baby Pavilion, LLC | 50 | 21,595 | 22,822 | (1,227) | (1,228) |
| Other | Various | 505 | 509 | (4) | 9 |
| | | 37,793 | 38,583 | 404 | 2,646 |

Children's received $0 and $2,309 in distributions from joint ventures for the years ended December 31, 2020 and 2019, respectively.

The following table represents summarized financial information for unconsolidated entities recorded under the equity method of accounting as of and for the years ended December 31:

| | | Unaudited | |
|---|---|---|---|
| | | **2020** | **2019** |
| Total assets | $ | 152,119 | 130,503 |
| Total liabilities | | 38,012 | 22,630 |
| Total net assets | | 114,108 | 107,873 |
| Total revenue | | 186,364 | 182,629 |
| Total operating expenses | | 174,700 | 162,442 |
| Excess of revenues over expenses | | 11,664 | 20,187 |

Investments accounted for under the cost method were $13,500 and $8,048 at December 31, 2020 and 2019, respectively, and are recorded as investments in unconsolidated joint ventures in other assets.

## (11) Commitments and Contingencies

### *(a) Litigation*

Children's is a defendant in legal proceedings arising in the ordinary course of business. Although the outcome of these proceedings cannot presently be determined, in the opinion of management, disposition of these proceedings will not have a material adverse effect on the consolidated financial statements of Children's.

### *(b) Compliance with Laws and Regulations*

The healthcare industry is subject to numerous laws and regulations of federal, state, and local governments. Compliance with these laws and regulations can be subject to government review and interpretations, as well as regulatory actions unknown and unasserted at this time. Government activity continues to focus on possible violations of regulations by healthcare providers, which could result in the imposition of significant fines and penalties, as well as significant repayments of previously billed and collected revenue. Management believes that Children's compliance procedures lead to substantial compliance with current laws and regulations.

### *(c) Letter of Credit*

Children's is required by the Minnesota Department of Commerce to maintain collateral for the purposes of funding the workers' compensation liabilities, which total $3,677. As of December 31, 2020, Children's has a surety bond in the amount of $4,370 to meet this requirement.

### *(d) Other Contractual Commitments*

Children's maintains various long-term, noncancelable contractual commitments with certain vendors for ongoing system maintenance and general business support. As of December 31, 2020 and 2019, commitments under these arrangements were $26,823 and $35,861, respectively.



(Continued)

## (12) Other Long-Term Liabilities

Other long-term liabilities for the years ended December 31, 2020 and 2019 consist of the following:

| | | 2020 | 2019 |
|---|---|---|---|
| RSVP retirement plan | $ | 1,408 | 284 |
| Other benefit plans | | 9,473 | 8,012 |
| Self-insured reserves | | 5,307 | 5,164 |
| Deferred revenue | | 2,331 | 2,820 |
| Other | | 7,537 | 1,072 |
| Total other long-term liabilities | $ | 26,056 | 17,352 |

## (13) Leases

Children's leases certain space and equipment under noncancelable operating leases with varying terms. The space leases also require a payment of an allocated share of common operating costs.

The weighted average terms of operating leases were 8.8 years and 9.4 years for the years ended December 31, 2020 and 2019, respectively. The weighted average discount rate of operating leases was 2.6% and 3.5% for the years ended December 31, 2020 and 2019, respectively.

Children's incurred operating lease expense of $7,259 and $6,955 for the years ended December 31, 2020 and 2019, respectively. Operating cash flows from operating leases were $7,340 and $7,198 for the years ended December 31, 2020 and 2019, respectively. Sublease rental income was $1,783 and $1,695 for the years ended December 31, 2020 and 2019, respectively.

Maturities of operating lease liabilities as of December 31, 2020 are as follows:

| | | |
|---|---|---|
| 2021 | $ | 7,050 |
| 2022 | | 7,173 |
| 2023 | | 6,881 |
| 2024 | | 6,334 |
| 2025 | | 5,778 |
| Thereafter | | 20,794 |
| Total future minimum lease payments | | 54,010 |
| Less imputed interest | | (5,274) |
| Total lease liabilities | $ | 48,736 |

Future minimum lease payments to be received as lessor under sublease arrangements as of December 31, 2020 are as follows:

| | | |
|---|---|---|
| 2021 | $ | 1,968 |
| 2022 | | 1,702 |
| 2023 | | 1,428 |
| 2024 | | 1,069 |
| 2025 | | 138 |
| Thereafter | | 392 |
| | $ | 6,697 |

# ADDITIONAL INFORMATION

**CHILDREN'S HEALTH CARE**

Consolidating Balance Sheet Information

December 31, 2020

(In thousands)

| Assets | Obligated group total | Children's Health Insurance Network, Ltd | Children's Health Network | Children's Home Medical Equipment | Eliminating entries | Consolidated total |
|---|---|---|---|---|---|---|
| Current assets: | | | | | | |
| Cash and cash equivalents | $ 23,336 | 3,754 | — | — | — | 27,090 |
| Short-term investments | 5,894 | — | — | — | — | 5,894 |
| Short-term investments, board-designated | 84 | — | — | — | — | 84 |
| Funds held by trustee | 7 | — | — | — | — | 7 |
| Patient accounts receivable | 121,421 | — | — | — | — | 121,421 |
| Prepaid expenses and other current assets | 58,800 | 3,002 | 105 | — | (13,677) | 48,230 |
| Total current assets | 209,542 | 6,756 | 105 | — | (13,677) | 202,726 |
| Long-term investments | 925,801 | 12,720 | — | — | — | 938,521 |
| Board-designated investments | 123,331 | — | — | — | — | 123,331 |
| Operating lease right-of-use assets, net | 37,385 | — | 18 | — | — | 37,403 |
| Other assets | 80,087 | — | — | — | (250) | 79,837 |
| Land, buildings, and equipment – net | 307,830 | — | 26 | 170 | — | 308,026 |
| Total | $ 1,683,976 | 19,476 | 149 | 170 | (13,927) | 1,689,844 |
| **Liabilities and Net Assets** | | | | | | |
| Current liabilities: | | | | | | |
| Current maturities of long-term debt | $ 2,113 | — | — | — | — | 2,113 |
| Current portion of operating lease liabilities | 5,876 | — | 18 | — | — | 5,894 |
| Accounts payable and accrued expenses | 46,753 | 11,131 | — | — | (13,677) | 44,207 |
| Accrued salaries, wages, and benefits | 59,820 | — | — | — | — | 59,820 |
| Other current liabilities | 13,169 | 1,208 | 750 | — | — | 15,127 |
| Total current liabilities | 127,731 | 12,339 | 768 | — | (13,677) | 127,161 |
| Intercompany accounts | 3,734 | — | (4,389) | 655 | — | — |
| Fair value of interest rate swaps | 25,251 | — | — | — | — | 25,251 |
| Other long-term liabilities | 22,763 | 3,293 | — | — | — | 26,056 |
| Long-term portion of operating lease liabilities | 42,842 | — | — | — | — | 42,842 |
| Long-term debt – excluding current maturities | 292,404 | — | — | — | — | 292,404 |
| Total liabilities | 514,725 | 15,632 | (3,621) | 655 | (13,677) | 513,714 |
| Net assets: | | | | | | |
| Net assets without donor restrictions | 1,092,103 | 3,844 | 3,770 | (485) | (250) | 1,098,982 |
| Net assets with donor restrictions | 77,148 | — | — | — | — | 77,148 |
| Total net assets | 1,169,251 | 3,844 | 3,770 | (485) | (250) | 1,176,130 |
| Total | $ 1,683,976 | 19,476 | 149 | 170 | (13,927) | 1,689,844 |

See accompanying notes to consolidating schedules of financial statements information.

**CHILDREN'S HEALTH CARE**

Consolidating Statement of Operations and Changes in Net Assets Information

Year ended December 31, 2020

(In thousands)

| | Obligated group total | Children's Health Insurance Network, Ltd | Children's Health Network | Children's Home Medical Equipment | Eliminating entries | Consolidated total |
|---|---|---|---|---|---|---|
| Revenue: | | | | | | |
| Patient service revenue | $ 785,252 | — | — | — | 1,294 | 786,546 |
| Net assets released from restrictions for operations | 6,343 | — | — | — | — | 6,343 |
| Other | 86,502 | 5,620 | 6,759 | — | (9,565) | 89,316 |
| Total revenue | 878,097 | 5,620 | 6,759 | — | (8,271) | 882,205 |
| Expenses: | | | | | | |
| Salaries, wages, and employee benefits | 514,095 | — | 4,759 | 187 | — | 519,041 |
| Professional fees and purchased services | 121,617 | 167 | 338 | 203 | (2,261) | 120,064 |
| Supplies | 101,249 | — | 18 | 1 | — | 101,268 |
| Facilities | 17,350 | — | 219 | — | — | 17,569 |
| Depreciation and amortization | 50,612 | — | 13 | 21 | — | 50,646 |
| Financing costs | 10,582 | — | — | — | (86) | 10,496 |
| Health services taxes | 25,657 | — | 21 | 5 | — | 25,683 |
| Other | 58,793 | 5,395 | 1,052 | 28 | (6,010) | 59,258 |
| Total expenses | 899,955 | 5,562 | 6,420 | 445 | (8,357) | 904,025 |
| Operating (loss) income | (21,858) | 58 | 339 | (445) | 86 | (21,820) |
| Nonoperating gains (losses): | | | | | | |
| Investment income and realized gains | 14,907 | 809 | 86 | — | (86) | 15,716 |
| Income on investments accounted for under the equity method | 404 | — | — | — | — | 404 |
| Net unrealized gains on investments | 46,612 | 139 | — | — | — | 46,751 |
| Change in fair value of interest rate swaps | (5,206) | — | — | — | — | (5,206) |
| Nonservice component of pension expense | (550) | — | — | — | — | (550) |
| Total nonoperating gains | 56,167 | 948 | 86 | — | (86) | 57,115 |
| Excess (deficiency) of revenue over expenses | 34,309 | 1,006 | 425 | (445) | — | 35,295 |
| Net assets without donor restrictions: | | | | | | |
| Net assets released from restrictions – capital acquisitions | — | — | | | — | — |
| RSVP plan–related changes other than net periodic plan expense | (636) | — | | | — | (636) |
| Other | — | — | | | — | — |
| Increase (decrease) in net assets without donor restrictions | 33,673 | 1,006 | 425 | (445) | — | 34,659 |
| Net assets with donor restrictions: | | | | | | |
| Contributions | 4,478 | — | — | — | — | 4,478 |
| Investment income | 654 | — | — | — | — | 654 |
| Net unrealized gains on investments | 3,865 | — | — | — | — | 3,865 |
| Net assets released from restrictions – operations | (6,343) | — | — | — | — | (6,343) |
| Net assets released from restrictions – capital acquisitions | — | — | — | — | — | — |
| Change in value of perpetual trusts held by others | 295 | — | — | — | — | 295 |
| Increase in net assets with donor restrictions | 2,949 | — | — | — | — | 2,949 |
| Increase in net assets | 36,622 | 1,006 | 425 | (445) | — | 37,608 |
| Net assets – beginning of year | 1,132,629 | 2,838 | 3,345 | (40) | (250) | 1,138,522 |
| Net assets – end of year | $ 1,169,251 | 3,844 | 3,770 | (485) | (250) | 1,176,130 |

See accompanying notes to consolidating schedules of financial statements information.

## (1) Obligated Group

Children's Health Care (Children's) master indenture provides for the creation of a group of entities (Obligated Group), the members of which are jointly and severally obligated for the payment of debt services on all obligations issued thereunder. The Obligated Group currently consists of Children's – Minneapolis and Children's – St. Paul; Children's Clinic Network, a Minnesota not-for-profit corporation that is a wholly controlled affiliate; Children's Health Care Services, Inc., d/b/a Children's – Minnetonka, a Minnesota not-for-profit corporation that is a wholly controlled affiliate; and Children's Health Care Foundation, d/b/a Children's Foundation, a wholly controlled affiliate that performs fundraising functions and endowment management. Children's Health Insurance Network, Ltd., a Cayman Island–domiciled insurance entity and Children's Minnesota Home Medical Equipment (CHME), which provides home medical equipment services, are wholly controlled affiliates of Children's and are not currently members of the Obligated Group. Children's is also the sole corporate and nonvoting member of Children's Health Network (CHN), a clinically integrated network created by Children's to be a leading advocate for providing the highest quality of care for children and their families. CHN is not currently a member of the Obligated Group.

## (2) Basis of Reporting

The consolidating schedule of balance sheet information and the consolidating schedule of statement of operations and changes in net assets information are presented for additional analysis of the sources and uses of funds within the consolidated amounts. All intercompany balances and transactions have been eliminated for consolidation purposes.