

Children's Hospital of Pittsburgh Foundation

Financial Statements

June 30, 2019 and 2018

Children's Hospital of Pittsburgh Foundation

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Independent Auditors' Report

To the Board of Directors of
Children's Hospital of Pittsburgh Foundation

We have audited the accompanying financial statements of Children's Hospital of Pittsburgh Foundation, which comprise the statements of financial position as of June 30, 2019 and 2018, and the related statements of activities and changes in net assets and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Children's Hospital of Pittsburgh Foundation as of June 30, 2019 and 2018, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Baker Tilly Virchow Krause, LLP

Pittsburgh, Pennsylvania
October 1, 2019

Children's Hospital of Pittsburgh Foundation

Statements of Financial Position

(Amounts in Thousands)

June 30, 2019 and 2018

	<u>2019</u>	<u>2018</u>		<u>2019</u>	<u>2018</u>
Assets			Liabilities and Net Assets		
Current Assets			Current Liabilities		
Cash and cash equivalents	\$ 2,028	\$ 540	Due to Children's Hospital of Pittsburgh of UPMC:		
Current portion of pledges receivable	7,700	4,615	Operating expenses	\$ 708	\$ 895
Current portion of assets whose use is limited	15,804	14,923	Annual financial support	2,039	1,851
Current portion of investments	<u>4,763</u>	<u>4,784</u>	Accrued expenses	<u>30</u>	<u>26</u>
Total current assets	30,295	24,862	Total current liabilities	2,777	2,772
Assets Whose Use is Limited, Board Designated	148,606	140,111	Other Long-Term Liabilities	<u>7</u>	<u>10</u>
Investments, Donor Restricted	114,569	116,469	Total liabilities	<u>2,784</u>	<u>2,782</u>
Pledges Receivable, Net	7,211	4,921			
Beneficial Interest in Charitable Remainder Trusts	286	288	Net Assets		
Beneficial Interest in Perpetual Trusts	<u>11,521</u>	<u>11,417</u>	Without donor restrictions	139,288	136,984
Total assets	<u>\$ 312,488</u>	<u>\$ 298,068</u>	With donor restrictions	<u>170,416</u>	<u>158,302</u>
			Total net assets	<u>309,704</u>	<u>295,286</u>
			Total liabilities and net assets	<u>\$ 312,488</u>	<u>\$ 298,068</u>

See notes to financial statements

Children's Hospital of Pittsburgh Foundation

Statements of Activities and Changes in Net Assets

(Amounts in Thousands)

Years Ended June 30, 2019 and 2018

	2019			2018		
	Without Donor Restrictions	With Donor Restrictions	Total	Without Donor Restrictions	With Donor Restrictions	Total
Revenues and Other Support						
Contributions and bequests	\$ 7,635	\$ 21,132	\$ 28,767	\$ 7,014	\$ 16,913	\$ 23,927
Interest and dividends, net of fees	2,528	1,621	4,149	3,772	2,767	6,539
Contributed services	157	-	157	157	-	157
Allowance for doubtful pledges and pledges written off	-	(94)	(94)	-	(45)	(45)
Total revenues and other support before net assets released from restrictions	10,320	22,659	32,979	10,943	19,635	30,578
Net assets released from restrictions used for, Annual financial support and other operating expenses	15,363	(15,363)	-	15,386	(15,386)	-
Total revenues and other support	25,683	7,296	32,979	26,329	4,249	30,578
Expenses						
Contributions to Children's Hospital of Pittsburgh of UPMC, Annual financial support and petition requests	21,263	-	21,263	21,102	-	21,102
Fundraising	6,791	-	6,791	6,497	-	6,497
General and administrative	2,171	-	2,171	1,325	-	1,325
Total expenses	30,225	-	30,225	28,924	-	28,924
(Decrease) Increase in Net Assets Before Other Changes in Net Assets	(4,542)	7,296	2,754	(2,595)	4,249	1,654
Other Changes in Net Assets						
Net realized and unrealized gain on investments	6,846	4,908	11,754	11,301	9,179	20,480
Valuation (loss) gain, beneficial interest in charitable remainder trusts	-	(2)	(2)	-	22	22
Valuation gain, beneficial interest in perpetual trusts	-	104	104	-	396	396
Transfer of net assets to Children's Hospital of Pittsburgh of UPMC	-	(192)	(192)	-	(365)	(365)
Increase in Net Assets	2,304	12,114	14,418	8,706	13,481	22,187
Net Assets, Beginning of Year	136,984	158,302	295,286	128,278	144,821	273,099
Net Assets, End of Year	\$ 139,288	\$ 170,416	\$ 309,704	\$ 136,984	\$ 158,302	\$ 295,286

See notes to financial statements

Children's Hospital of Pittsburgh Foundation

Statements of Cash Flows

(Amounts in Thousands)

Years Ended June 30, 2019 and 2018

	<u>2019</u>	<u>2018</u>
Cash Flows from Operating Activities		
Increase in net assets	\$ 14,418	\$ 22,187
Adjustments to reconcile increase in net assets to net cash used in operating activities:		
Provision for doubtful pledges	105	55
Net realized and unrealized gains on investments	(11,754)	(20,480)
Valuation loss (gain), beneficial interest in charitable remainder trusts	2	(22)
Valuation gain, beneficial interest in perpetual trusts	(104)	(396)
Contributions of endowment funds restricted in perpetuity	(1,664)	(2,267)
Changes in assets and liabilities:		
Pledges receivable	(5,480)	(2,319)
Due to Children's Hospital of Pittsburgh of UPMC:		
Operating expenses	(187)	272
Annual financial support	188	308
Accrued expenses	4	4
Other long-term liabilities	(3)	(4)
	<u>(4,475)</u>	<u>(2,662)</u>
Net cash used in operating activities	(4,475)	(2,662)
Cash Flows Provided by (Used in) Investing Activities		
Net sales (purchases) and maturities of investments and assets whose use is limited	4,299	(953)
Cash Flows Provided by Financing Activities		
Contributions of endowment funds restricted in perpetuity	<u>1,664</u>	<u>2,267</u>
Net increase (decrease) in cash and cash equivalents	1,488	(1,348)
Cash and Cash Equivalents, Beginning of Year	<u>540</u>	<u>1,888</u>
Cash and Cash Equivalents, End of Year	<u><u>\$ 2,028</u></u>	<u><u>\$ 540</u></u>

See notes to financial statements

Children's Hospital of Pittsburgh Foundation

Notes to Financial Statements

(Amounts in Thousands)

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1. Organization

Children's Hospital of Pittsburgh Foundation (the "Foundation") was created on July 1, 2000, primarily to support the fund-raising and development efforts of the Children's Hospital of Pittsburgh. The Foundation is a non-profit organization as described in Section 501(c)(3) of the Internal Revenue Code (the "IRC") and is exempt from federal income taxes on related income pursuant to Section 501(a) of the IRC.

2. Affiliation Agreement

On October 31, 2001, Children's Hospital of Pittsburgh consummated an affiliation with University of Pittsburgh Medical Center ("UPMC Health System" or "UPMC") pursuant to the terms of the Integration and Affiliation Agreement (the "Affiliation Agreement") by and among the Children's Hospital of Pittsburgh, the Foundation, and UPMC Health System (collectively the "Parties"). As a result of the Affiliation Agreement, Children's Hospital of Pittsburgh became Children's Hospital of Pittsburgh of UPMC (the "Hospital"). Under the terms of the Affiliation Agreement, the Foundation was reorganized such that the Children's Hospital of Pittsburgh was no longer the sole corporate member of the Foundation and the Foundation has no corporate member. The Foundation is structured as a supporting organization of the Hospital.

The terms of the Affiliation Agreement provide that UPMC Health System would construct a new pediatric hospital (the "New CHP") for the Hospital. Pursuant to an amendment entered into by the Parties on September 28, 2004, the Foundation was required to provide funding for the New CHP in the amount of \$50,000 (the "Initial Funding Commitment"). The Initial Funding Commitment was fulfilled upon completion of the New CHP in May 2009.

In January 2007, the Affiliation Oversight Committee approved an increase to the projected cost for the design and construction of the New CHP of \$46,800 and the Foundation agreed in September 2007 to fund the \$46,800 increased project costs ("Additional Funding Commitment"). The Additional Funding Commitment was fulfilled in October 2013.

The Affiliation Agreement required the Hospital, after receiving Orphan's Court and regulatory approval, to transfer to the Foundation certain unrestricted and restricted investments, as well as the Hospital's beneficial interests in certain perpetual trusts. The Affiliation Agreement requires that the Foundation, for a minimum of 20 years, will provide annual financial support equal to 5 percent of the rolling average corpus of such transferred investments, beneficial interests in certain perpetual trusts and donations received thereafter, unless the original donor specified a different spending provision. This annual funding commitment is conditional upon the Hospital delivering to the Foundation a broad range of funding requests, and to meet certain standards selected by the Parties as indicators of the Hospital's continued or improved performance.

3. Summary of Significant Accounting Policies

Basis of Presentation

The financial statements of the Foundation have been prepared in conformity with accounting principles generally accepted in the United States of America, including accounting regulations as they relate to financial statements of not-for-profit organizations. The Financial Accounting Standards Board's ("FASB") guidance requires the reporting of total assets, liabilities and net assets in a statement of financial position; reporting the change in net assets in a statement of activities; and reporting the sources and uses of cash and cash equivalents in a statement of cash flows.

Children's Hospital of Pittsburgh Foundation

Notes to Financial Statements

(Amounts in Thousands)

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Net assets and revenues, gains, expenses and losses are classified as without donor restriction or with donor restriction based on the existence or absence of donor-imposed restrictions as follows:

Net assets without donor restrictions - Net assets that are not subject to donor-imposed stipulations. Net assets without donor restrictions may be designated for specific purposes by action of the Board of Directors (the "Board") or may otherwise be limited by contractual agreements with outside parties.

Net assets with donor restrictions - Net assets whose use by the Foundation is subject to donor-imposed stipulations that can be fulfilled by actions of the Foundation pursuant to those stipulations or that expire by the passage of time are reported as net assets with donor restrictions. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, these net assets with donor restrictions are reclassified to net assets without donor restrictions and reported in the statements of activities and changes in net assets as net assets released from donor restrictions. Additionally, funds received as gifts and bequests which have been accepted with the donor stipulation that the principal be maintained intact in perpetuity are reported as net assets with donor restrictions.

Use of Estimates

The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Subsequent Events

The Foundation evaluated subsequent events for recognition or disclosure through October 1, 2019, the date the financial statements were available to be issued.

Cash and Cash Equivalents

Cash and cash equivalents include highly liquid investments with an original maturity of three months or less at the date of purchase, excluding assets whose use is limited and investments.

No collateral or security is provided on these investments, other than the insurance on interest bearing deposits per financial institution by the Federal Deposit Insurance Corporation. The Foundation has not experienced any losses from maintaining these accounts in excess of federally insured limits. Management believes it is not subject to significant risks associated with these accounts.

Pledges Receivable

Unconditional pledges to contribute cash and other assets are reported at their estimated fair value at the date the promise is received. Pledges receivable that are expected to be collected within one year are recorded at their net realizable value. Pledges receivable that are expected to be collected in future years are recorded at the present value of estimated net realizable future cash flows. The discount rate used was 1.71 percent at June 30, 2019 and 2.63 percent at June 30, 2018.

The Foundation annually evaluates the collectability of its pledges receivable and either reserves for or writes off uncollectible pledges when it is determined the pledge is uncollectible.

Conditional promises to give are not included as support until such time as the conditions are substantially met.

Children's Hospital of Pittsburgh Foundation

Notes to Financial Statements

(Amounts in Thousands)

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Investments and Assets Whose Use Is Limited

The Foundation's investments are reported in the statements of financial position as follows:

- **Assets Whose Use is Limited, Board Designated** - These investments represent funds where the Board has restricted the use over the corpus, and funds of which the Board retains control and may at its discretion subsequently use for other purposes.
- **Investments, Donor Restricted** - These investments represent primarily endowed funds for which the corpus is restricted and the related investment income is restricted for specifically designated expenditures.

Investments are primarily maintained in a master trust fund administered using a bank as the trustee. Investments are in equity investments, fixed income investments and alternative investment strategies, including hedge funds and private equity.

Investments with readily determinable fair values and all investments in debt securities are measured at fair value in the statements of financial position. Investment income or loss (including realized and unrealized gains and losses on investments, interest and dividends, net of investment fees) is included in the determination of increase in net assets without donor restrictions unless the income is restricted by donor or law. Interest income is recorded as earned on the accrual basis using the effective yield method. Dividends are recorded on the accrual basis based on the ex-dividend date.

The fair value of the Foundation's alternative investments is based on the beginning value of the Foundation's interest in the investment plus actual contributions and allocated investment income or loss less actual distributions and allocated administrative expense. If available, quoted market prices are used to value alternative investments. Securities that have no available quoted market price are presented at estimated fair value as determined by the trustee using the net asset value practical expedient.

Although the Foundation's investments are invested in a variety of financial instruments, the related fair values, as reported in the statements of financial position, are subject to various market risks, including changes in the equity markets, the interest rate environment and economic conditions. Due to the level of risk associated with investment securities and the level of uncertainty related to changes in the fair value of investment securities, it is reasonably possible that the fair value of investments reported in the accompanying statements of financial position could materially change in the near future.

Beneficial Interest in Charitable Remainder Trusts

The Foundation has been designated as the beneficiary of certain charitable remainder trusts created by donors and held by entities other than the Foundation. Under the terms of the trusts, the Foundation will receive a portion of the assets that remain in the trusts when they are terminated, typically upon death of the current beneficiary. Upon being designated as the beneficiary, the Foundation recorded an asset and recognized contribution revenues with donor restrictions. The beneficial interest recorded by the Foundation is measured at the present value of the estimated future cash payments to be distributed to the Foundation. Subsequent changes in fair value are recorded as valuation gains or losses in net assets with donor restrictions.

Beneficial Interest in Perpetual Trusts

The Foundation has been designated as the beneficiary of certain perpetual trusts created by donors and held by entities other than the Foundation. Under the terms of the trusts, the Foundation will receive a portion of the income earned on trust assets in perpetuity. Upon being designated as the beneficiary, the Foundation recorded an asset and recognized contribution revenues with donor restrictions. The beneficial interest recorded by the Foundation is measured at the fair value of the Foundation's interest in the trust assets. Subsequent changes in fair value are recorded as valuation gains or losses in net assets with donor restrictions.

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Donor Restricted Gifts

The Affiliation Agreement provides that all contributions from donors received for the benefit of the Hospital will be recorded and maintained by the Foundation. Contributions are considered to be available for use unless specifically restricted by the donor. Amounts received that are designated for future periods or restricted by the donor for specific purposes are reported as support with donor restrictions. 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 statements of activities and changes in net assets as net assets released from restrictions.

Income Tax Status

The Foundation is a non-profit organization as described in Section 501(c)(3) of the IRC, and is exempt from federal taxes on its exempt income under Section 501(a) of the IRC. Accordingly, no provision for federal and state income taxes is recorded.

The Foundation accounts for uncertainty in income taxes using a recognition threshold of more-likely-than-not to be sustained upon examination by the appropriate taxing authority. Measurement of the tax uncertainty occurs if the recognition threshold is met. Management determined there were no tax uncertainties that met the recognition threshold at June 30, 2019 and 2018.

New Accounting Standard Adopted

During 2019, the Foundation adopted the FASB Accounting Standards Update ("ASU") No. 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. ASU No. 2016-14 addresses the complexity and understandability of net asset classification, deficiencies in information about liquidity and availability of resources, and the lack of consistency in the type of information provided about expenses and investment return. The Foundation has adjusted the presentation of these financial statements accordingly. ASU No. 2016-14 has been applied retrospectively to all periods presented.

The new standard changes the following aspects of the financial statements:

- The unrestricted net asset class has been renamed Net Assets Without Donor Restrictions;
- The temporarily and permanently restricted net asset classes have been combined into a single net asset class named Net Assets With Donor Restrictions;
- The financial statements include a disclosure about liquidity and availability of resources at June 30, 2019 and 2018;
- The functional expense disclosure for 2019 and 2018 includes expenses reported both by nature and function.

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(Amounts in Thousands)

June 30, 2019 and 2018

As a result of the adoption of ASU No. 2016-14, the net assets of the Foundation as of June 30, 2018 were reclassified as follows:

	After Adoption of ASU No. 2016-14	As Originally Presented
Net assets without donor restrictions	\$ 136,984	\$ -
Net assets with donor restrictions	158,302	-
Net assets, unrestricted	-	136,984
Net assets, temporarily restricted	-	94,455
Net assets, permanently restricted	-	63,847
Total	<u>\$ 295,286</u>	<u>\$ 295,286</u>

New Accounting Standards Not Yet Adopted

During January 2016, the FASB issued ASU No. 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities*. The provisions of ASU No. 2016-01: (a) requires equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income; (b) eliminates the requirement to disclose the fair value of financial instruments measured at amortized cost for entities that are not public business entities; (c) eliminates the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the statement of financial position. ASU No. 2016-01 is effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. The Foundation has not yet determined the impact of ASU No. 2016-01 on its financial statements.

During June 2018, the FASB issued ASU No. 2018-08, *Not-for-Profit Entities (Topic 958): Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*. The new guidance is intended to clarify and improve accounting guidance for contributions received and contributions made. The amendments in this ASU should assist entities in: (1) evaluating whether transactions should be accounted for as contributions (nonreciprocal transactions) or as exchange (reciprocal) transactions subject to other guidance; and (2) determining whether a contribution is conditional. ASU No. 2018-08 is effective for fiscal years beginning after December 15, 2018. The Foundation is currently assessing the impact that ASU No. 2018-08 will have on its results of operations, financial position and cash flows.

4. Pledges Receivable

Pledges receivable consist of the following at June 30:

	2019	2018
Pledges due within one year	\$ 7,700	\$ 4,615
Pledges due in one to five years	6,771	4,722
Pledges due in more than five years	1,089	920
Total pledges receivable, gross	15,560	10,257
Less discount to net present value	649	721
Total pledges receivable, net	14,911	9,536
Less current portion of pledges receivable	7,700	4,615
Non-current portion of pledges receivable	<u>\$ 7,211</u>	<u>\$ 4,921</u>

Children's Hospital of Pittsburgh Foundation

Notes to Financial Statements

(Amounts in Thousands)

June 30, 2019 and 2018

5. Investments and Assets Whose Use is Limited

Investments and assets whose use is limited consist of the following at June 30:

	<u>2019</u>	<u>2018</u>
Cash and cash equivalents	\$ 3,339	\$ 1,696
U.S. government obligations	10,445	9,676
Corporate bonds	18,677	18,038
Mutual funds:		
International	73,755	71,394
Large-Cap	65,152	65,725
Mid-Cap	10,511	10,485
Small-Cap	9,954	10,542
Exchange traded fund	8,681	8,618
Alternative investments:		
Long-short strategy fund	40,533	37,224
Private equity strategy fund	16,773	13,924
Private investment partnership funds	21,134	23,789
Distressed debt funds	4,788	5,176
	<u>\$ 283,742</u>	<u>\$ 276,287</u>

Investments and assets whose use is limited are reported in the accompanying statements of financial position as follows:

	<u>2019</u>	<u>2018</u>
Current portion of assets whose use is limited	\$ 15,804	\$ 14,923
Current portion of investments	4,763	4,784
Assets whose use is limited, board designated	148,606	140,111
Investments, donor restricted	114,569	116,469
	<u>\$ 283,742</u>	<u>\$ 276,287</u>

The current portions of assets whose use is limited and investments are based upon management's estimate of the amounts required to meet the Foundation's annual financial support to the Hospital in the following year.

The Foundation's investments, primarily held with PNC Bank, consist of cash and cash equivalents, mutual funds, an exchange traded fund, corporate bonds, government obligations and certain alternative investments. The fair value of the Foundation's alternative investments have been valued using the net asset value practical expedient in the absence of readily determinable fair values. Management's estimates are based on information provided by the fund managers or the general partners of these investments.

The Foundation's private investment partnership investment fund and distressed debt fund agreements obligate the Foundation to provide advance funding periodically up to specified levels. The Foundation had unfunded commitments of \$6,359 at June 30, 2019 and \$8,278 at June 30, 2018 to a variety of private equity, natural resources, venture capital and international funds. The Foundation expects these commitments to be funded over the next several years, depending on market conditions.

The Foundation's private investment partnership funds and distressed debt funds cannot be redeemed. Instead, the nature of these investments is that distributions are received through the liquidation of the underlying assets of the funds. The Foundation does have the ability to sell these funds on secondary markets.

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(Amounts in Thousands)

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Total investment return, net of related investment fees, consists of the following:

	<u>2019</u>	<u>2018</u>
Interest and dividends	\$ 4,239	\$ 6,620
Less investment fees	<u>(90)</u>	<u>(81)</u>
Interest and dividends, net	4,149	6,539
Net realized and unrealized gains	<u>11,754</u>	<u>20,480</u>
Total investment return	<u>\$ 15,903</u>	<u>\$ 27,019</u>

6. Fair Value Measurements

The Foundation measures its investments and assets whose use is limited, beneficial interest in charitable remainder trusts, and beneficial interest in perpetual trusts at fair value on a recurring basis in accordance with accounting principles generally accepted in the United States of America. Fair value is defined as the price that would be received to sell an asset or the price that would be paid to transfer a liability in an orderly transaction between market participants at the measurement date. The framework that the authoritative guidance establishes for measuring fair value includes a hierarchy used to classify the inputs used in measuring fair value. The hierarchy prioritizes the inputs used in determining valuations into three levels. The level in the fair value hierarchy within which the fair value measurement falls is determined based on the lowest level input that is significant to the fair value measurement.

The levels of the fair value hierarchy are as follows:

Level 1 - Fair value is based on unadjusted quoted prices in active markets that are accessible to the Foundation for identical assets. These generally provide the most reliable evidence and are used to measure fair value whenever available.

Level 2 - Fair value is based on significant inputs, other than Level 1 inputs, that are observable either directly or indirectly for substantially the full term of the asset through corroboration with observable market data. Level 2 inputs include quoted market prices in active markets for similar assets, quoted market prices in markets that are not active for identical or similar assets, and other observable inputs.

Level 3 - Fair value is based on significant unobservable inputs. Examples of valuation methodologies that would result in Level 3 classification include option pricing models, discounted cash flows, and other similar techniques.

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The following tables present the Foundation's financial instruments measured and reported at fair value at June 30, 2019 and 2018:

	2019			Total Fair Value
	Level 1	Level 2	Level 3	
Investments and assets whose use is limited:				
Cash and cash equivalents	\$ 3,339	\$ -	\$ -	\$ 3,339
U.S. government obligations	10,445	-	-	10,445
Corporate bonds	18,677	-	-	18,677
Mutual funds	159,372	-	-	159,372
Exchange traded fund	8,681	-	-	8,681
Long-short strategy fund	-	40,533	-	40,533
Private equity strategy fund	-	16,773	-	16,773
Total	200,514	57,306	-	257,820
Investments and assets whose use is limited reported at net asset value:				
Private investment partnership funds				21,134
Distressed debt funds				4,788
Total investments and assets whose use is limited				283,742
Beneficial interest in charitable remainder trusts	-	-	286	286
Beneficial interest in perpetual trusts	-	-	11,521	11,521
Total	\$ 200,514	\$ 57,306	\$ 11,807	\$ 295,549
	2018			
Investments and assets whose use is limited:				
Cash and cash equivalents	\$ 1,696	\$ -	\$ -	\$ 1,696
U.S. government obligations	9,676	-	-	9,676
Corporate bonds	18,038	-	-	18,038
Mutual funds	158,146	-	-	158,146
Exchange traded fund	8,618	-	-	8,618
Long-short strategy fund	-	37,224	-	37,224
Private equity strategy fund	-	13,924	-	13,924
Total	196,174	51,148	-	247,322
Investments and assets whose use is limited reported at net asset value:				
Private investment partnership funds				23,789
Distressed debt funds				5,176
Total investments and assets whose use is limited				276,287
Beneficial interest in charitable remainder trusts	-	-	288	288
Beneficial interest in perpetual trusts	-	-	11,417	11,417
Total	\$ 196,714	\$ 51,148	\$ 11,705	\$ 287,992

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The changes in the assets measured at fair value on a recurring basis included in Level 3 assets are summarized as follows for the years ended June 30:

	2019		
	Beneficial Interest in Remainder Trusts	Beneficial Interest in Perpetual Trusts	Total
Balance, beginning of year	\$ 288	\$ 11,417	\$ 11,705
Valuation (loss) gain	(2)	104	102
Balance, end of year	<u>\$ 286</u>	<u>\$ 11,521</u>	<u>\$ 11,807</u>
Gain (loss) included in change in net assets attributable to assets held at end of year	<u>\$ (2)</u>	<u>\$ 104</u>	<u>\$ 102</u>
	2018		
Balance, beginning of year	\$ 266	\$ 11,021	\$ 11,287
Valuation gain	22	396	418
Balance, end of year	<u>\$ 288</u>	<u>\$ 11,417</u>	<u>\$ 11,705</u>
Gain included in change in net assets attributable to assets held at end of year	<u>\$ 22</u>	<u>\$ 396</u>	<u>\$ 418</u>

The following is a description of the valuation methodologies used for financial instruments reported at fair value. There have been no changes in methodologies used at June 30, 2019 and 2018.

The carrying amounts of cash and cash equivalents approximate fair value due to the short-term nature of these instruments.

Corporate bonds and U.S. government obligations are valued at fair value based on quoted market prices for identical securities in active markets that the Foundation has the ability to access at the measurement date.

Mutual funds and exchange traded funds are valued at fair value, based on quoted market prices for identical securities in active markets that the Foundation has the ability to access at the measurement date.

The Foundation's long-short strategy fund and private equity strategy fund are valued based upon the fair value of the fund's underlying assets. Due to the nature of these funds, there are no unfunded commitments or redemption restrictions.

The Foundation's private investment partnership funds and distressed debt funds have been valued using the net asset value practical expedient in the absence of readily determinable fair values. Management's estimates are based on information provided by the fund managers or the general partners of these investments.

The private investment partnership funds' investment objective is to seek the preservation of capital and to provide long-term rates of return in excess of the publicly traded markets. The Foundation is invested in eight separate funds invested in a variety of markets, including venture capital, domestic private equity, international private equity and natural resources.

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The distressed debt funds' investment objective is to seek the preservation of capital and to provide long-term rates of return comparable to returns generated by top performing domestic fixed income funds. The Foundation is invested in five separate funds invested in a variety of corporate equity and debt instruments.

The beneficial interest in charitable remainder trusts is valued at fair value based on the net present value of the future distributions of the trust assets.

The beneficial interest in perpetual trusts is valued at fair value based on the Foundation's interest in the fair value of the assets held by the trust, which represents a proxy for the discounted present value of future cash flows.

The following is a description of the valuation methodologies used for financial instruments disclosed at fair value. There have been no changes in methodologies used at June 30, 2019 and 2018.

The carrying amounts of cash and cash equivalents not included in investments and assets whose use is limited approximate fair value due to the short-term nature of these instruments.

The carrying value of pledges receivable is based on the original contributions amount, adjusted by a discount rate that a market participant would demand and an evaluation for uncollectible contributions.

The preceding methods may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Foundation believes its valuation method is appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

7. Liquidity and Availability of Resources

The following table reflects the Foundation's financial assets available for general expenditure within one year at June 30, 2019 and 2018. Financial assets are considered unavailable when illiquid or not convertible to cash within one year. Unavailable financial assets consist of donor restricted funds not expected to be released from restrictions within the next year, and investments with redemption restrictions.

	<u>2019</u>	<u>2018</u>
Financial assets:		
Cash and cash equivalents	\$ 2,028	\$ 540
Current portion of pledges receivable	7,700	4,615
Current portion of assets whose use is limited	15,804	14,923
Current portion of investments	4,763	4,784
Assets whose use is limited, board designated	<u>148,606</u>	<u>140,111</u>
Total financial assets	178,901	164,973
Less financial assets unavailable for general expenditures within one year:		
Current portion of pledges receivable whose proceeds are donor restricted	(7,517)	(4,172)
Investments with redemption restrictions	<u>(25,922)</u>	<u>(28,965)</u>
Total financial assets available to meet cash needs for general expenditures within one year	<u>\$ 145,462</u>	<u>\$ 131,836</u>

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As part of the Foundation's liquidity management, it has a policy to structure its financial assets to be available as its general expenditures, liabilities and other obligations come due. The Foundation invests cash in excess of daily requirements at the discretion of the Board.

The Foundation's investments in the long-short strategy fund and private equity strategy fund (Note 5) require a 35 day notice for withdrawals. In the absence of any material market disruptions, the investment trustee is required to timely satisfy any such withdrawal requests. In times of market disruption and with respect to investments that may not be readily marketable, the investment trustee will use reasonable efforts to satisfy the Foundation's withdrawal request, and will treat the request and effect withdrawals on a pro-rata basis with other pending withdrawal requests, if any, received from other investors in the master trust fund. In no event shall any unfulfilled withdrawal request remain outstanding for more than one year from the date of the request.

8. Net Assets With Donor Restrictions

Net assets with donor restrictions consist of the following at June 30:

	<u>2019</u>	<u>2018</u>
Restricted for specific purposes:		
Research	\$ 22,624	\$ 20,031
Healthcare services and programs	<u>80,495</u>	<u>74,424</u>
Total restricted for specific purposes	<u>103,119</u>	<u>94,455</u>
Restricted in perpetuity:		
Endowment funds	53,429	51,697
Beneficial interest in perpetual trusts	11,521	11,417
Pledges receivable, proceeds to be permanently restricted	<u>2,347</u>	<u>733</u>
Total restricted in perpetuity	<u>67,297</u>	<u>63,847</u>
Total net assets with donor restrictions	<u>\$ 170,416</u>	<u>\$ 158,302</u>

The income earned from endowment funds is primarily restricted to support research activities. The income generated from beneficial interests in perpetual trusts is available for operations unless restricted as established by each trust agreement. The restricted purposes as established by certain trusts includes benevolent care and special purpose funds.

9. Endowment Funds

The Foundation's endowments were established for a variety of purposes, and include both donor-restricted endowment funds and funds designated by the Board to function as endowments. As required by FASB authoritative guidance, net assets associated with endowment funds, including funds designated by the Board to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

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Interpretation of Relevant Law

The Foundation interprets the Commonwealth of Pennsylvania Act 141 ("PA Act 141") as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds, absent explicit donor stipulations to the contrary. Further it is also the Foundation's interpretation that the PA Act 141 allows for the use of 5 percent of the fair value of the gift to the extent that the investment return was not sufficient to fund the purpose of the gift during the year. As a result of this interpretation, the Foundation classifies as net assets with donor restrictions to be held in perpetuity: (a) the original value of gifts donated to the endowment; and (b) the original value of subsequent gifts to the endowment. The remaining portion of the donor-restricted endowment fund is classified as net assets with donor restrictions until those amounts are appropriated for expenditure by the Foundation in a manner consistent with the standard of prudence prescribed by PA Act 141.

Endowment Fund Activity

The Foundation's endowment funds consist of the following at June 30:

	<u>2019</u>	<u>2018</u>
Available for expenditures for specific purposes	\$ 48,727	\$ 47,715
Original corpus restricted in perpetuity	<u>53,429</u>	<u>51,697</u>
Total endowment funds	<u>\$ 102,156</u>	<u>\$ 99,412</u>

The changes in endowment net assets is comprised of the following for the years ended June 30, 2019 and 2018:

	<u>2019</u>		
	<u>Available for Expenditures</u>	<u>Restricted in Perpetuity</u>	<u>Total</u>
Endowment net assets, beginning of year	\$ 47,715	\$ 51,697	\$ 99,412
Investment return	6,528	-	6,528
Contributions	-	1,661	1,661
Reclassifications and other changes	-	71	71
Appropriation of endowment assets for expenditures, annual transfer for operations	<u>(5,516)</u>	<u>-</u>	<u>(5,516)</u>
Endowment net assets, end of year	<u>\$ 48,727</u>	<u>\$ 53,429</u>	<u>\$ 102,156</u>
	<u>2019</u>		
Endowment net assets, beginning of year	\$ 42,394	\$ 49,647	\$ 92,041
Investment return	11,946	-	11,946
Contributions	-	1,934	1,934
Reclassifications and other changes	(111)	116	5
Appropriation of endowment assets for expenditures, annual transfer for operations	<u>(6,514)</u>	<u>-</u>	<u>(6,514)</u>
Endowment net assets, end of year	<u>\$ 47,715</u>	<u>\$ 51,697</u>	<u>\$ 99,412</u>

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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 PA Act 141 requires the Foundation to retain as a fund of perpetual duration. In accordance with FASB authoritative guidance deficiencies of this nature that are reported in net assets with donor restrictions were \$0 and \$5 at June 30, 2019 and 2018, respectively.

Return Objectives and Risk Parameters

The investment philosophy of the Foundation is based on a disciplined, consistent and diversified approach utilizing multiple asset classes and multiple managers. The Foundation's intent is to accommodate styles and strategies considered reasonable and prudent. Assets are invested with investment managers who invest in mutual funds, exchange traded funds and corporate bonds and governmental obligations. Additionally, a portion of the funds are invested in alternative investments which include investments in private investment partnership funds, a long-short strategy fund, private equity strategy fund and distressed debt funds. The primary objective is to grow the assets to ensure the Foundation can continue to support the Hospital's operations.

Strategies Employed for Achieving Objectives

To satisfy its long-term rate of return objectives, the Foundation relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The Foundation targets a diversified asset allocation that is set by the Foundation's Finance and Investment Committee. The investment assets are invested according to the following asset allocation guideline:

	<u>Current Targets</u>	<u>Long-Term Future Target Range</u>
Domestic large-cap equity	20.00 %	15.00 - 30.00 %
Domestic mid to small-cap equity	7.50	5.00 - 15.00
International developed equity	13.75	8.00 - 18.50
Emerging markets	13.75	8.00 - 18.50
Fixed income	10.00	8.00 - 25.00
Hedge funds	15.00	5.00 - 20.00
Private equity	20.00	10.00 - 30.00

Spending Policy and How the Investment Objectives Relate to Spending Policy

PA Act 141 states that provided an organization adopts and follows an investment policy seeking a total return for the assets held, the organization may annually select a spending percentage between 2 percent and 7 percent of the three year average fair market value of the assets held by an organization.

The Affiliation Agreement requires that the Foundation, for a minimum of 20 years, will provide annual financial support equal to 5 percent of the rolling 12 quarter average of the corpus (defined as the value of all of the Foundation's assets less any funds held by the Foundation where the donor has directed a different spending provision). Such calculation includes the endowment funds. Any shortfalls of earnings may be made from excess earnings in prior years.

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10. Related Party Transactions

Annual Financial Support

The Foundation entered into an agreement to provide annual financial support to the Hospital for a period of 20 years (Note 2). The Foundation provided annual financial support of \$21,263 in 2019 and \$21,102 in 2018. Amounts owed to the Hospital under this agreement were \$2,039 at June 30, 2019 and \$1,851 at June 30, 2018.

Operating Expenses

Certain expenditures, primarily operating expenses, are paid by the Hospital and subsequently reimbursed by the Foundation. Accounts payable relating to these transactions were \$708 at June 30, 2019 and \$895 at June 30, 2018.

Contributed Services

The Foundation entered into a lease agreement with the Hospital in 2010 which was amended in 2015. Under the amended agreement, the Hospital agreed to provide office space to the Foundation through August 2020.

The Hospital contributed \$157 of office space to the Foundation in 2019 and 2018. Expenses related to these contributed services are included in general and administrative expenses in the statements of activities and changes in net assets.

11. Functional Expenses

The Foundation's primary purpose is to support the fundraising and development efforts of the New CHP. Expenses by functional classification consist of the following for the years ended June 30, 2019 and 2018:

	2019			
	Program	Fundraising	General and Administrative	Total
Salaries and wages	\$ -	\$ 3,439	\$ 841	\$ 4,280
Employee benefits and payroll taxes	-	740	373	1,113
Contracted services and professional fees	-	1,143	169	1,312
Office supplies and expenses	-	126	236	362
Event expenses	-	630	-	630
Other expenses	-	713	552	1,265
Contributions to Children's Hospital of Pittsburgh of UPMC, annual financial support and petition requests	21,263	-	-	21,263
Total	\$ 21,263	\$ 6,791	\$ 2,171	\$ 30,225

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	2018			
	<u>Program</u>	<u>Fundraising</u>	<u>General and Administrative</u>	<u>Total</u>
Salaries and wages	\$ -	\$ 3,562	\$ 561	\$ 4,123
Employee benefits and payroll taxes	-	883	139	1,022
Contracted services and professional fees	-	316	140	456
Office supplies and expenses	-	417	195	612
Event expenses	-	551	-	551
Other expenses	-	768	290	1,058
Contributions to Children's Hospital of Pittsburgh of UPMC, annual financial support and petition requests	21,102	-	-	21,102
Total	<u>\$ 21,102</u>	<u>\$ 6,497</u>	<u>\$ 1,325</u>	<u>\$ 28,924</u>

12. Commitments

The Hospital entered into an agreement to lease new office space for the Foundation subsequent to June 30, 2019. As part of this agreement, the Foundation has agreed to reimburse the Hospital for the costs of certain leasehold improvements up to \$2,000. As of June 30, 2019, costs incurred on the leasehold improvements were approximately \$100.