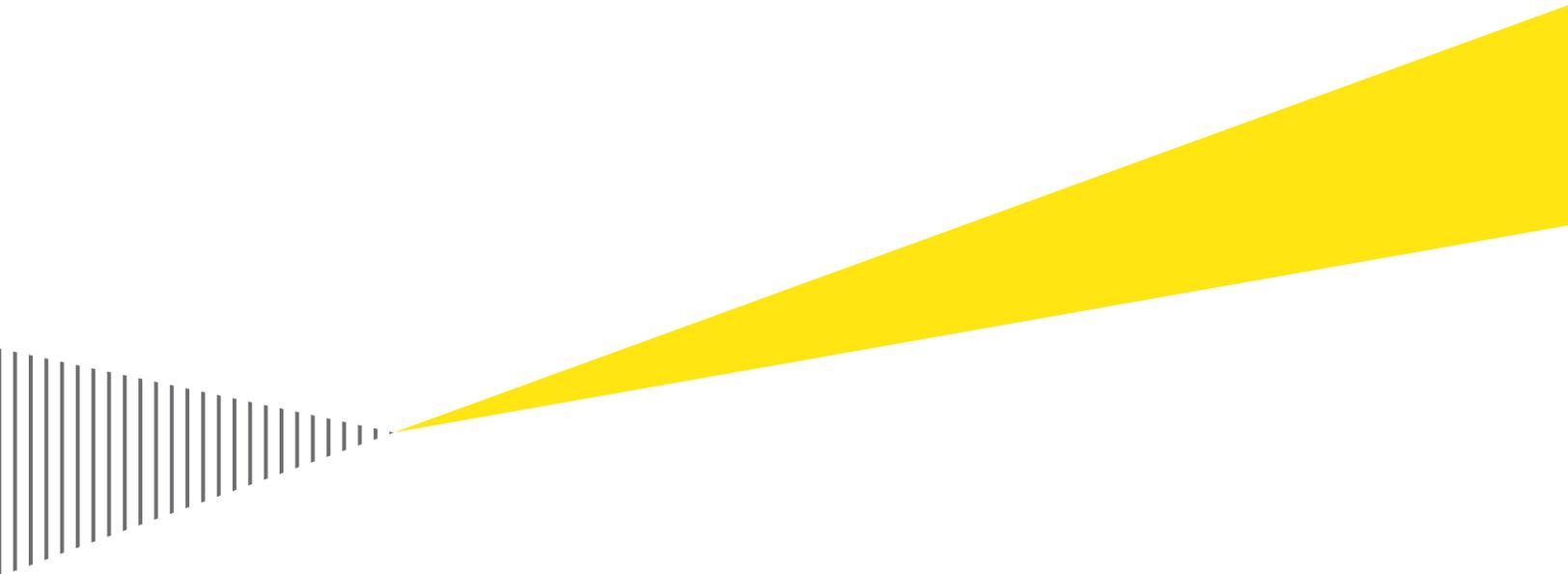


CONSOLIDATED FINANCIAL STATEMENTS AND
SUPPLEMENTARY INFORMATION

City of Hope
Years Ended September 30, 2018 and 2017
With Report of Independent Auditors

Ernst & Young LLP



Building a better
working world

City of Hope

Consolidated Financial Statements and Supplementary Information

Years Ended September 30, 2018 and 2017

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Report of Independent Auditors

The Board of Directors
City of Hope

We have audited the accompanying consolidated financial statements of City of Hope, which comprise the consolidated statements of financial position as of September 30, 2018 and 2017, and the related consolidated statements of activities 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 financial statements in conformity 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 financial statements that are free of material misstatement, whether due to fraud or error.

Auditor’s 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of 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 consolidated financial position of City of Hope as of September 30, 2018 and 2017, and the consolidated results of their activities and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying consolidating statements of financial position as of September 30, 2018 and 2017, and the consolidating statements of activities for the years then ended are presented for purposes of additional analysis 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 audits of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the information is fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.

Ernst + Young LLP

December 19, 2018

City of Hope

Consolidated Statements of Financial Position
(In Thousands)

	September 30	
	2018	2017
Assets		
Current assets:		
Cash and cash equivalents	\$ 377,571	\$ 212,067
Investments	1,526,106	1,191,963
Self-insurance trust funds	3,765	3,352
Patient accounts receivable, less allowances for uncollectible accounts of \$10,916 in 2018 and \$5,688 in 2017	238,384	245,192
Grants and other receivables	95,981	66,070
Due from third-party payors	342	9,817
Donor-restricted unconditional promises to give, net	18,576	49,399
Prepaid and other	39,105	36,654
Total current assets	<u>2,299,830</u>	<u>1,814,514</u>
Property and equipment, net	930,236	861,850
Other assets:		
Investments held for long-term purposes	302,822	313,812
Board-designated assets	884,127	815,638
Donor-restricted assets:		
Investments	518,251	442,913
Unconditional promises to give, net	60,741	54,036
Contributions receivable from annuity and split-interest agreements, net	13,182	13,623
Other	9,452	3,535
Intangible assets	6,067	6,086
Goodwill and other technology	63,667	4,600
Other long-term assets	47,428	53,211
Total other assets	<u>1,905,737</u>	<u>1,707,454</u>
Total assets	<u><u>\$ 5,135,803</u></u>	<u><u>\$ 4,383,818</u></u>

	September 30	
	2018	2017
Liabilities and net assets		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 150,229	\$ 157,051
Accrued salaries, wages, and employee benefits	87,473	68,783
Long-term debt, current portion	13,051	11,650
Deferred revenue	28,404	27,284
Other	324	834
Total current liabilities	<u>279,481</u>	265,602
Long-term debt, net of current portion	1,003,810	683,411
Annuity and split-interest agreement obligations	20,464	18,580
Deferred rent	10,146	14,028
Interest rate swap	6,549	10,266
Other	60,115	56,501
Total liabilities	<u>1,380,565</u>	1,048,388
Net assets:		
Unrestricted:		
Controlling interests	3,121,881	2,788,493
Non-controlling interests in subsidiaries	35,100	–
Temporarily restricted	406,564	370,801
Permanently restricted	191,693	176,136
Total net assets	<u>3,755,238</u>	3,335,430
Total liabilities and net assets	<u><u>\$ 5,135,803</u></u>	<u><u>\$ 4,383,818</u></u>

See accompanying notes.

City of Hope

Consolidated Statement of Activities (In Thousands)

Year Ended September 30, 2018

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Revenues:				
Contributions (including \$31,983 of contributions from special events)	\$ 79,686	\$ 71,517	\$ 14,958	\$ 166,161
Special event participation revenue	4,346	-	-	4,346
Less: cost of direct benefits to donors	(7,292)	-	-	(7,292)
Contributions and net revenues from special events	<u>76,740</u>	<u>71,517</u>	<u>14,958</u>	<u>163,215</u>
Net patient service revenues	1,375,498	-	-	1,375,498
Research grants and clinical trials	152,821	-	-	152,821
Investment income	166,164	17,958	315	184,437
Net unrealized gain on investments	20,669	6,473	-	27,142
Royalty and licensing revenues	500,370	-	-	500,370
Other	42,921	1,361	284	44,566
Total revenues	<u>2,335,183</u>	<u>97,309</u>	<u>15,557</u>	<u>2,448,049</u>
Net assets released from restrictions	61,546	(61,546)	-	-
Total revenues and other increases	<u>2,396,729</u>	<u>35,763</u>	<u>15,557</u>	<u>2,448,049</u>
Expenses:				
Program services:				
Patient care	1,034,821	-	-	1,034,821
Research	538,080	-	-	538,080
Public information and education	24,891	-	-	24,891
Total program services	<u>1,597,792</u>	<u>-</u>	<u>-</u>	<u>1,597,792</u>
Supporting services:				
Administrative and general	438,589	-	-	438,589
Fundraising	26,771	-	-	26,771
Total supporting services	<u>465,360</u>	<u>-</u>	<u>-</u>	<u>465,360</u>
Total expenses	<u>2,063,152</u>	<u>-</u>	<u>-</u>	<u>2,063,152</u>
Excess of revenues and other increases over expenses	333,577	35,763	15,557	384,897
Contributed capital, non-controlling interest	34,911	-	-	34,911
Changes in net assets	<u>368,488</u>	<u>35,763</u>	<u>15,557</u>	<u>419,808</u>
Net assets, beginning of year	2,788,493	370,801	176,136	3,335,430
Net assets, end of year	<u>\$ 3,156,981</u>	<u>\$ 406,564</u>	<u>\$ 191,693</u>	<u>\$ 3,755,238</u>

See accompanying notes.

City of Hope

Consolidated Statement of Activities (In Thousands)

Year Ended September 30, 2017

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Revenues:				
Contributions (including \$25,173 of contributions from special events)	\$ 67,258	\$ 72,830	\$ 7,458	\$ 147,546
Special event participation revenue	5,173	-	-	5,173
Less: cost of direct benefits to donors	(8,357)	-	-	(8,357)
Contributions and net revenues from special events	64,074	72,830	7,458	144,362
Net patient service revenues	1,186,167	-	-	1,186,167
Research grants and clinical trials	135,104	-	-	135,104
Investment income	127,714	13,405	173	141,292
Net unrealized gain on investments	165,339	15,054	-	180,393
Royalty and licensing revenues	398,096	-	-	398,096
Other	23,404	119	-	23,523
Total revenues	2,099,898	101,408	7,631	2,208,937
Net assets released from restrictions	44,566	(44,566)	-	-
Total revenues and other increases	2,144,464	56,842	7,631	2,208,937
Expenses:				
Program services:				
Patient care	916,607	-	-	916,607
Research	448,796	-	-	448,796
Public information and education	17,429	-	-	17,429
Total program services	1,382,832	-	-	1,382,832
Supporting services:				
Administrative and general	359,423	-	-	359,423
Fundraising	30,020	-	-	30,020
Total supporting services	389,443	-	-	389,443
Total expenses	1,772,275	-	-	1,772,275
Excess of revenues and other increases over expenses	372,189	56,842	7,631	436,662
Inherent contribution from Affiliation	20,947	25,410	62	46,419
Changes in net assets	393,136	82,252	7,693	483,081
Net assets, beginning of year	2,395,357	288,549	168,443	2,852,349
Net assets, end of year	<u>\$ 2,788,493</u>	<u>\$ 370,801</u>	<u>\$ 176,136</u>	<u>\$ 3,335,430</u>

See accompanying notes.

City of Hope

Consolidated Statements of Cash Flows (In Thousands)

	Year Ended September 30	
	2018	2017
Operating activities		
Changes in net assets	\$ 419,808	\$ 483,081
Adjustments to reconcile changes in net assets to net cash (used in) provided by operating activities:		
Depreciation and amortization	126,298	118,861
Amortization of bond issuance costs	127	118
Amortization of bond discount	206	187
Amortization of bond premium	(1,646)	(1,692)
Net gain on sale of contributed real property held for sale	(609)	(43)
Inherent contribution from Affiliation	-	(46,419)
Contributed capital, non-controlling interests	(34,911)	-
Loss on disposal of fixed assets	543	1,161
Loss on impairment of intangible assets	-	3,910
Provision for bad debt	8,481	7,769
Net unrealized gain on investments	(27,142)	(180,393)
Gain on equity method investments	(125)	(49,600)
Gain on lease modification	(3,580)	-
Change in value of interest rate swap	(3,718)	(6,686)
Contribution proceeds restricted for endowment	(20,193)	(5,261)
Changes in assets and liabilities:		
Patient accounts receivable, net	(324)	(8,589)
Grants and other receivables	(35,569)	5,740
Unconditional promises to give, net	24,118	15,054
Contributions receivable from split-interest agreements	441	1,513
Contributed real property held for sale	(350)	457
Other assets	(2,001)	(20,103)
Accounts payable and accrued liabilities	(51,897)	(24,461)
Accrued salaries, wages, and employee benefits	18,690	9,370
Annuity and split-interest agreement obligations	1,884	1,316
Other liabilities	9,078	(870)
Net cash provided by operating activities before net (purchases) sales of trading investments	427,609	304,420
Net (purchases) sales of trading investments	(509,622)	33,774
Net cash (used in) provided by operating activities	(82,013)	338,194
Investing activities		
Increase in notes receivable	(194)	(3,061)
Additions to property and equipment	(110,085)	(201,385)
Cash from Affiliation	-	10,598
Cash paid to SCRO non-controlling interests	(23,494)	-
Proceeds from sale of contributed real property held for sale	3,121	73
Net sales (purchases) of alternative investments	73,026	(50,969)
Net cash used in investing activities	(57,626)	(244,744)

City of Hope

Consolidated Statements of Cash Flows (continued) (In Thousands)

	Year Ended September 30	
	2018	2017
Financing activities		
Repayment of long-term debt	\$ —	\$ (65,000)
Proceeds from long-term debt borrowing, net	298,555	67,855
Principal payments on long-term debt	(15,350)	(10,959)
Bond issuance costs	(1,057)	—
Working capital contribution, non-controlling interests	2,802	—
Contribution proceeds restricted for endowment	20,193	5,261
Net cash provided by (used in) financing activities	305,143	(2,843)
Net increase in cash and cash equivalents	165,504	90,607
Cash and cash equivalents, beginning of year	212,067	121,460
Cash and cash equivalents, end of year	\$ 377,571	\$ 212,067
Supplemental disclosure of cash flow information:		
Interest paid during the year (net of capitalized interest)	\$ 36,752	\$ 33,881
Supplemental disclosure of non-cash activity:		
Assets constructed by landlord	\$ 10,891	\$ 23,127
Capital lease obligation	\$ 48,045	\$ —
Additions to property and equipment included in accounts payable and accrued liabilities	\$ 45,088	\$ 39,433
Non-cash consideration from non-controlling interests	\$ 32,110	\$ —

See accompanying notes.

City of Hope

Notes to Consolidated Financial Statements

September 30, 2018

1. Organization

City of Hope, a California nonprofit public benefit corporation, with its principal office located in Duarte, California, is the development organization of City of Hope National Medical Center (the Center), City of Hope Medical Foundation (the Foundation), Beckman Research Institute of the City of Hope (the Institute) (collectively, the Obligated Group), The Translational Genomics Research Institute (TGen), Southern California Radiation Oncology, LLC (SCRO) and the City of Hope Auxiliaries (the Auxiliaries) (collectively, the Affiliated Group). These entities represent the consolidated City of Hope organization (collectively referred to as City of Hope). City of Hope's management and staff coordinate the fundraising activities of the many volunteers and donors needed to support the patient care and research mission of the City of Hope.

The Center, located in Duarte, California, is a California nonprofit public benefit corporation treating primarily cancer and other life-threatening diseases. The Center currently operates a 186-bed tertiary referral center with a licensed capacity of 217 beds. City of Hope is the sole corporate member of the Center.

The Foundation, located in Duarte, California, is a California nonprofit public benefit corporation organized as part of a coordinated health care delivery system to provide teaching, education, and research services in support of the Center and the Institute. The Foundation also owns and/or operates outpatient clinic facilities that provide an extensive range of medical care and treatment. City of Hope is the sole corporate member of the Foundation.

The Institute, located in Duarte, California, is a California nonprofit public benefit corporation that owns and operates a number of major research facilities on or near City of Hope's main campus. The Institute conducts basic scientific research in support of and in conjunction with the patient care activities of the Center and the Foundation. City of Hope is the sole corporate member of the Institute.

TGen, located in Phoenix, Arizona, is an Arizona nonprofit public benefit corporation that translates genomic discoveries into advances in human health. TGen employs innovative advances arising from the Human Genome Project and applies them to the development of diagnostics. The accounts of TGen include the assets, liabilities, and results of operations of TGen Foundation and certain other controlled entities that were created to support TGen through its various functions. City of Hope became the sole corporate member of TGen effective upon an affiliation on November 17, 2016 (the Affiliation) (see Note 7).

City of Hope

Notes to Consolidated Financial Statements (continued)

1. Organization (continued)

SCRO, a California for-profit joint venture, was formed on March 30, 2018 between the Foundation and Vantage Oncology Treatment Centers, LLC (Vantage) to manage and provide services to nine freestanding radiation therapy centers in Southern California. The Foundation owns 50.1% and Vantage owns 49.9% of SCRO. (See Note 7)

The Auxiliaries, located throughout the United States, are nonprofit public benefit unincorporated associations that coordinate fundraising activities to support the mission of City of Hope.

Principles of Consolidation

The accompanying consolidated financial statements of City of Hope include the accounts of the Obligated Group and the Affiliated Group. All intercompany accounts and transactions have been eliminated in the consolidated financial statements.

Investments in companies for which City of Hope does not exercise control and where there is significant influence over the operations of the company are accounted for under the equity method of accounting.

Collective Bargaining Agreements

The City of Hope is subject to six collective bargaining agreements related to certain members of its labor force. Approximately 52% of employees are covered under collective bargaining agreements as of September 30, 2018. Three of the six agreements will expire within one year of September 30, 2018, and these agreements are anticipated to be renegotiated and renewed for one to three years, depending on the agreement.

2. Summary of Significant Accounting Policies

Use of Estimates

The preparation of the City of Hope consolidated financial statements in conformity with accounting principles generally accepted in the United States 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 consolidated financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Principal areas requiring the use of estimates include determination of the net realizable value of patient

City of Hope

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

accounts receivable, valuation of unconditional promises to give, cost report settlements and amounts due to/from third-party payors, valuation of annuity and split-interest agreement obligations, fair value of interest rate swap agreements, fair value of business combinations, impairment of goodwill and other intangibles, and self-insured liabilities. Actual results could differ from those estimates and the amounts could be material to the consolidated financial statements.

Cash and Cash Equivalents

Cash and cash equivalents reflect all unrestricted cash and cash equivalents that include highly liquid investments with original or remaining maturities at purchase of three months or less and exclude amounts whose use is limited under contractual or donor agreements.

Cash and cash equivalents that are held as a component of donor restricted assets are reflected in donor restricted investments in the accompanying consolidated statements of financial position.

Cash is held in depository accounts at various financial institutions. The combined account balance at any given institution may exceed the Federal Deposit Insurance Corporation (FDIC) insurance coverage of \$250,000 and, as a result, there is a concentration of credit risk related to amounts on deposit in excess of FDIC insurance coverage. Management believes, based on the quality of the financial institutions, that the risk is not significant.

Contributions

All contributions are considered available for the program services of and for distribution unless specifically restricted by the donor. Amounts received that are designated for future periods or are restricted by the donor for specific purposes are reported as temporarily restricted or permanently restricted contributions.

Temporarily restricted net assets consist of assets restricted by donors for specific purposes until time restrictions lapse and/or the purpose for the restriction is accomplished. These net assets are primarily available for use in future periods. Permanently restricted net assets have been restricted by donors in perpetuity, the income from which is expendable to support patient care, research, or other designated purposes. All other net assets are unrestricted.

City of Hope

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Restricted monetary gifts that are specifically designated are held until such time as the designation is met. When a donor restriction is met, a stipulated time restriction ends, or a purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the consolidated statements of activities as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same fiscal period as the contributions are received are reflected as net assets released from restrictions in the accompanying consolidated statements of activities.

City of Hope is the beneficiary under various wills and trust agreements of which the total realizable amount is not readily determinable at the date of gift. In the case of wills, such amounts are recognized as contributions when the will is declared valid by a probate court and the proceeds are measurable. For the years ended September 30, 2018 and 2017, valid will and trust agreement amounts that became measurable totaled \$39,173,000 and \$29,504,000, respectively, and are included in contributions in the accompanying consolidated statements of activities.

City of Hope reports unconditional promises to give as temporarily restricted contributions, unless otherwise restricted by the donor. Unconditional promises to give that are expected to be collected in future years are recorded at the present value of their estimated future cash flows. The discounts on these amounts are computed using risk-free interest rates approximating the U.S. Treasury Note rate when the unconditional promise is made. The rates used in 2018 and 2017 were between 1.20% and 3.46% and 1.50% and 1.72%, respectively.

Net unconditional promises to give in the accompanying consolidated statements of financial position consist of the following as of September 30 (amounts in thousands):

	2018	2017
Unconditional promises to give	\$ 90,029	\$ 116,109
Less:		
Discounts	(4,885)	(3,423)
Allowance for uncollectible promises to give	(5,827)	(9,251)
Total unconditional promises to give, net	79,317	103,435
Less current portion	(18,576)	(49,399)
	\$ 60,741	\$ 54,036

City of Hope

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

The allowance for uncollectible promises to give has been determined based on historical collection experience. Changes in the allowance for uncollectible promises to give and the amortization of pledge discounts is included in contribution revenue.

At September 30, 2018, future cash flows anticipated from unconditional promises to give are as follows (amounts in thousands):

2019	\$	20,017
2020		24,979
2021		9,380
2022		7,594
2023		4,546
Thereafter		<u>23,513</u>
		90,029
Discounts		(4,885)
Allowance for uncollectible promises to give		<u>(5,827)</u>
	\$	<u><u>79,317</u></u>

City of Hope reports conditional promises to give as contribution revenue when the conditions stipulated by the donor are met, at which time the conditional promise becomes unconditional. Prior to September 30, 2018, City of Hope received a conditional promise in the amount of \$35,000,000. There are specific project goals and milestones that must be met in order to receive the payments under the agreement. As of September 30, 2018 and 2017, \$5,000,000 and \$17,500,000, respectively, has been recorded in contribution revenue in recognition of attaining project goals and milestones. The remaining \$12,500,000 of this conditional promise has not been recognized in contribution revenue due to remaining project goals and milestones still subject to completion by City of Hope.

Split-Interest Obligations

City of Hope receives contributions from various types of split-interest agreements, including charitable gift annuities, charitable remainder annuity trusts, and charitable remainder unitrusts. City of Hope may be named as trustee or as a co-trustee or a financial institution may be named as the trustee.

City of Hope

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Under a charitable gift annuity arrangement, City of Hope recognizes the agreement in the period in which the contract is executed. The assets from the donor are recognized at fair value, and the liabilities designated by the donor to various beneficiaries are recognized at the present value of the estimated future payments to be distributed by City of Hope to such beneficiaries. The amount of the temporarily restricted contribution revenue is the difference between these assets and liabilities.

Under charitable remainder annuity trust and charitable remainder unitrust arrangements in which City of Hope is either not the trustee or is named as a co-trustee, City of Hope recognizes, in the period the agreement is executed, temporarily restricted long-term receivables and contribution revenues at the present value of the estimated future benefits to be received when the trust assets are expected to be distributed. Trust distributions are recorded as a reduction in receivables, while adjustments to the receivables to reflect amortization of the discount and changes in actuarial assumptions during the term of the trust are recorded as temporarily restricted contributions in the accompanying consolidated statements of activities. Receivables totaling \$13,182,000 as of September 30, 2018 are to be collected over the next 31.3 years and have an average remaining life of 14.8 years.

Under a charitable remainder annuity trust or a charitable remainder unitrust arrangement in which City of Hope is the trustee, City of Hope records the assets contributed to the trust by the donor at fair value when received and the liabilities designated by the donor to various beneficiaries are recognized at the present value of the estimated future payments to be distributed by City of Hope to such beneficiaries. The amount of the temporarily restricted contribution revenue is the difference between these assets and liabilities.

In-Kind Contributions

In-kind contributions are reflected at their estimated fair market value on the date of the donation. City of Hope reports gifts of land, buildings, equipment, and other nonmonetary contributions as unrestricted support, unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how and how long the donated assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as temporarily restricted. Absent explicit donor stipulations about how long those long-lived assets must be maintained, City of Hope reports expirations of donor restrictions as net assets released from restrictions when the donated or acquired long-lived assets are placed in service.

City of Hope

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Supplies Inventory

Inventories, consisting of materials, pharmaceuticals, and medical supplies for use in program services provided by City of Hope, are stated at the lower of cost or market using the first-in, first-out method. Inventories are included in prepaid and other current assets in the consolidated statements of financial position and totaled \$23,583,000 and \$19,744,000 at September 30, 2018 and 2017, respectively.

Property and Equipment

Property and equipment are stated at cost when purchased or at fair market value on the contribution date in the case of a donation. When property and equipment are sold or otherwise disposed of, the cost and related accumulated depreciation and amortization are removed from the accounts and any resulting gain or loss is included in administrative and general expenses. The costs of normal maintenance, repairs, and minor replacements are charged to expense when incurred.

City of Hope provides for depreciation and amortization using the straight-line method over the following estimated useful lives:

Buildings and improvements	7 to 40 years
Equipment and furniture	5 to 10 years
Software	3 to 5 years

Leasehold improvements are amortized on a straight-line basis over the term of the lease or estimated useful life, whichever is shorter. Leases that have been capitalized are amortized over the life of the lease. Capital lease amortization is included with depreciation and amortization expense.

City of Hope

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

A summary of the cost and accumulated depreciation and amortization of property and equipment as of September 30 is as follows (amounts in thousands):

	<u>2018</u>	<u>2017</u>
Land	\$ 17,175	\$ 15,998
Buildings and improvements	803,928	765,495
Equipment and furniture	509,575	442,324
Software	335,124	217,957
Leased capital assets	88,081	40,036
Construction in progress	82,279	181,025
Total property and equipment	1,836,162	1,662,835
Accumulated depreciation and amortization	(905,926)	(800,985)
Property and equipment, net	<u>\$ 930,236</u>	<u>\$ 861,850</u>

Total accumulated amortization for leased capital assets totaled \$18,578,000 and \$14,771,000 as of September 30, 2018 and 2017, respectively.

City of Hope reviews long-lived assets for impairment when events or changes in business conditions indicate that their carrying value may not be recoverable. Impairment is considered when the associated expected undiscounted cash flows are less than the carrying value and the assets will be written down to fair value at that time. Fair value is the present value of the associated cash flows. As of September 30, 2018, no long-lived assets are considered impaired.

Software Development Costs

All software development costs incurred in the planning stage of developing the software are expensed as incurred, as are internal and external training costs and maintenance costs. Internal and external costs (excluding general, administrative and overhead costs) incurred during the applicable development stage of internally used software, are capitalized. Such costs include external direct costs of materials and services consumed in developing or obtaining the software, payroll, and payroll-related costs for employees who are directly associated with and who devote time to developing the software. Development changes that result in significant enhanced functionality to the software are also capitalized.

City of Hope

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Capitalized internally used software development costs are amortized on a straight-line basis over an estimated useful life of five years. Amortization begins when all substantial testing of the software is completed and the software is ready for its intended use.

Unamortized software development costs included within property and equipment totaled \$124,313,000 and \$36,033,000 as of September 30, 2018 and 2017, respectively. Total amortization expense related to capitalized software development costs was \$40,185,000 and \$46,260,000 for the years ended September 30, 2018 and 2017, respectively. Software development costs included in construction in progress totaled \$13,134,000 and \$100,771,000 at September 30, 2018 and 2017, respectively. Included in construction in progress is capital costs associated with an Electronic Medical Record (EMR) totaling \$96,065,000 as of September 30, 2017 which was placed into service in December 2017 with a useful life of five years.

Interest and Capitalized Interest

Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. Interest cost incurred totaled \$38,597,000 and \$32,581,000 in 2018 and 2017, respectively. Interest cost capitalized totaled \$2,344,000 and \$4,950,000 in 2018 and 2017, respectively.

Deferred Revenue

City of Hope is the recipient of the proceeds of various fundraising events and other fundraising activities. City of Hope receives cash during the year for these fundraising events and defers recognition of the revenue received in advance of fundraising events held subsequent to the fiscal year-end. City of Hope defers recognition of certain unexpended grant and royalty monies received from various sources, including research grants and other agreements prior to the expenditures of

City of Hope

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

funds for such research or prior to such funds being earned. The following is a summary of deferred revenue as of September 30 (amounts in thousands):

	<u>2018</u>	<u>2017</u>
Fundraising events and other efforts	\$ 3,896	\$ 4,672
Royalty revenue	558	3,066
Unexpended grants/agreements	<u>23,950</u>	20,580
Total deferred revenue	<u>28,404</u>	28,318
Amount included in other long-term liabilities	–	(1,034)
	<u>\$ 28,404</u>	<u>\$ 27,284</u>

Income Taxes

City of Hope is exempt from federal income tax under Section 501(c)(3) of the U.S. Internal Revenue Code. City of Hope, the Center, Foundation and Institute are exempt from California state franchise and income tax under Section 23701d of the California Revenue and Taxation Code. TGen is exempt from Arizona corporate income tax under Section 43-1201(A) of the Arizona Revised Statutes (A.R.S.).

The 100% wholly owned entities of TGen are single-member, limited liability companies and are considered disregarded entities for tax purposes.

SCRO is treated as a partnership for federal and state income tax purposes where all taxable income is allocated to the partners in accordance with the respective partnership agreement; accordingly, federal and state taxes on income are the responsibility of the joint partners individually.

Financial Accounting Standards Board (FASB) Accounting Standards Codification Topic (ASC) 740, *Income Taxes*, clarifies the accounting for income taxes by prescribing a minimum recognition threshold that a tax position is required to meet before being recognized in the financial statements. ASC 740 also provides guidance on de-recognition, measurement, classification, interest and penalties, disclosure, and transition. The guidance contained in ASC 740 is applicable to pass-through entities and tax-exempt organizations. City of Hope has no significant uncertain tax positions or tax liability for tax benefits, interest, or penalties accrued at September 30, 2018 and 2017.

City of Hope

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

The Tax Cuts and Jobs Act (the Act) was enacted on December 22, 2017. The provisions of the Act did not have a material tax effect on the City of Hope consolidated financial statements. Certain regulatory guidance provides for a measurement period of up to one year during which accounting for the tax effects of the Act may be completed. City of Hope will continue to evaluate the impact of the Act and may record adjustments as additional information and guidance is released by the Internal Revenue Service.

Workers' Compensation Program

City of Hope, the Center, the Foundation and the Institute have elected to self-insure their workers' compensation liability. Reinsurance has been obtained for this program to cover claims that exceed \$250,000 between 1991 and 2002, \$500,000 in 2003, and \$1,000,000 per individual claim beginning in 2004. As of September 30, 2018 and 2017, an estimated liability of \$21,164,000 and \$20,726,000, respectively, has been recorded. The estimated current portion of the liability, totaling \$3,889,000 and \$3,523,000 as of September 30, 2018 and 2017, respectively, is included in accrued salaries, wages, and benefits in the consolidated statements of financial position and the estimated long-term portion of the liability, totaling \$17,275,000 and \$17,203,000 as of September 30, 2018 and 2017, respectively, is included in other long-term liabilities in the consolidated statements of financial position. Accruals for uninsured claims and claims incurred but not reported are estimated by an actuary based on prior claims experience. The estimated liability was recorded using a 2.85% and 1.75% discount factor as of September 30, 2018 and 2017, respectively.

As of September 30, 2018 and 2017, insurance recoveries related to workers' compensation totaling \$3,679,000 and \$4,650,000, respectively, has been reflected in the accompanying consolidated statements of financial position in other assets.

Workers' compensation expense charged to operations totaled \$7,022,000 and \$5,893,000 in 2018 and 2017, respectively.

Professional Liability Insurance

The Center, the Foundation and the Institute maintain professional liability insurance under a claims-made program, which provides coverage for claims arising out of incidents that have occurred from November 1, 1997 to September 30, 2015, with limits up to \$50,000,000 and a deductible of \$100,000 through June 30, 2014, and \$250,000 between July 1, 2014 and

City of Hope

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

September 30, 2018. Accruals for uninsured claims and claims incurred but not reported are estimated by an actuary based on prior claims experience. Such accruals were recorded using a 2.85% and 1.75% discount factor as of September 30, 2018 and 2017, respectively. An estimated liability of \$1,595,000 and \$2,125,000 as of September 30, 2018 and 2017, respectively, is included in other current and long-term liabilities in the consolidated statements of financial position. The professional liability insurance expense charged to operations amounted to \$1,242,000 and \$1,845,000 in 2018 and 2017, respectively.

The Center, the Foundation and the Institute recorded insurance recoveries related to professional liability totaling \$443,000 and \$748,000, which have been reflected in the accompanying consolidated statements of financial position in other assets as of September 30, 2018 and 2017, respectively.

Retirement Plans

City of Hope, the Center, Foundation, and the Institute participate in the City of Hope Defined Contribution Plan (the Plan). The Plan was established in 1989 to provide benefits to eligible employees as defined in the plan document and covers substantially all employees. Contributions range between 2% and 10%, depending on years of service and salary, and are calculated on biweekly base salary up to and above the annual Social Security Taxable wage base, not to exceed the maximum covered compensation of \$275,000 in 2018. Employees are eligible upon the completion of one year of service in which they have worked at least 1,000 hours. They may direct these contributions into various funds offered through the Plan.

The Center and the Institute also participate in the City of Hope Research Staff Organization (RSO) Tax Deferred Annuity Plan (the RSO TDA Plan) that was established in 1983 to provide benefits to eligible members of the City of Hope RSO as defined in the plan document. Employer contributions of 15% of each participant's biweekly eligible salary are made up to a defined annual maximum base salary of \$275,000 in 2018. The participants have the ability to direct these contributions into various funds offered through the RSO TDA Plan.

TGen has a defined contribution Profit Sharing Plan (PSP Plan) that covers all employees who are 21 years of age and who have completed one month of service. Under the terms of the PSP Plan, employees may make voluntary contributions, subject to Internal Revenue Service limitations. TGen matches employee contributions up to 4% of the employee's annual compensation, subject to certain eligibility criteria as stated in the plan document.

City of Hope

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Contribution expense for the plans defined above totaled \$24,678,000 and \$21,765,000 in 2018 and 2017, respectively.

On January 1, 2006, the 2006 Executive Supplemental Accumulation Plan (the 457(f) Plan) was established. This plan provides designated executives with deferred compensation equal to 10% of the executive's base salary (net of City of Hope's, the Center's, the Foundation's, and the Institute's contribution to the participant's defined contribution plan). A participant becomes fully vested upon completion of three plan years of service, at age 65, or if they leave involuntarily. There is the possibility of substantial forfeiture should the participant leave voluntarily or involuntarily for cause prior to fully vesting. Contribution expense for the 457(f) Plan totaled \$1,583,000 and \$1,099,000 in 2018 and 2017, respectively.

Net Patient Service Revenues

Net patient service revenues are reported at net realizable amounts from third-party payors and others for services rendered. City of Hope's policy includes the evaluation of a patient's ability to pay. The allowances for contractual discounts and uncollectible accounts have been determined based on historical collection data and other factors, including changes to contract terms.

The Center and the Foundation have agreements with third-party payors that provide for payments to the Center and the Foundation at amounts different from established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, per diem payments, case rates, and specialized fee schedules. Estimated retroactive adjustments under the Medicare and Medi-Cal programs are also reflected in net patient service revenues. Patient service revenues, net of contractual allowances, and discounts for the years ended September 30 are as follows (amounts in thousands):

	<u>2018</u>	<u>2017</u>
Medicare	\$ 269,817	\$ 260,353
Medi-Cal	205,364	78,656
Managed care (including Medicare and Medi-Cal managed care)	878,091	827,832
Indemnity, self-pay, and other	22,226	19,326
Net patient service revenues	<u>\$ 1,375,498</u>	<u>\$ 1,186,167</u>

City of Hope

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

The Center and the Foundation are reimbursed for services provided to patients under certain programs administered by governmental agencies. Laws and regulations governing the Medicare and Medi-Cal programs are complex and subject to interpretation. Compliance with such laws and regulations can be subject to future governmental review and interpretation, as well as significant regulatory action, including fines, penalties, and exclusion from the Medicare and Medi-Cal programs. The Center and the Foundation believe that they are in compliance with all applicable laws and regulations, and they are not aware of any pending or threatened investigations involving allegations of potential wrongdoing.

Medicare reimburses the Center for cost-reimbursable items at an interim rate, and final settlements are determined after an audit of the Center's related annual cost reports by the Medicare fiscal intermediary. Estimated provisions to approximate the full expected settlements after review by the intermediary are included in the accompanying consolidated financial statements.

Expected settlement amounts are included in due from third-party payors in the consolidated statements of financial position. Estimation differences between final settlements and amounts accrued in previous years are reported as adjustments of the current year's net patient service revenues. In the opinion of management, adequate provision has been made for any adjustments that might result from this review. During 2018 and 2017, the Center received information requiring changes in its estimates of settlements due for certain open cost report years and appeals. Based on this information, the Center recorded a reduction to net patient service revenues totaling \$7,671,000 and an increase to net patient service revenues totaling \$2,114,000 for the years ended September 30, 2018 and 2017, respectively.

City of Hope

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Patient Accounts Receivable

The Center and the Foundation receive payment for services rendered to patients from federal and state governmental programs, mainly Medicare and Medi-Cal, privately sponsored managed care programs (including Medicare and Medi-Cal managed care) for which payment is made based on terms defined under formal contracts, and other payors. The following table summarizes the percentages of gross accounts receivable from patients and third-party payors as of September 30:

	<u>2018</u>	<u>2017</u>
Medicare	24%	25%
Medi-Cal	13	8
Managed care, other third-party payors, and patients	63	67
	<u>100%</u>	<u>100%</u>

Patient Charity Care

The Center and the Foundation approve charity care for patients meeting financial eligibility and clinical criteria at the time of admission or provision of service. A patient is classified as a charity patient by reference to certain established policies of the Center and the Foundation. Essentially, these policies define charity care as those services provided that are medically necessary but are never expected to result in cash receipts. Benefits for the indigent include services provided to persons who cannot afford health care because of inadequate resources or who are uninsured or underinsured. Also, certain medically necessary services may be provided to Medi-Cal patients, which are not reimbursed by the Medi-Cal program. The cost related to these services is included in the estimated cost of patient charity care.

The estimated cost for both patient charity care and Medi-Cal patients represents total direct and indirect cost calculated at the medical procedure level and pertains specifically to the respective charity and Medi-Cal patient populations. Procedure-level cost includes the direct costs, such as labor and supplies, involved in providing the specific service, as well as an applicable allocation of departmental overhead (e.g., departmental management) and institutional overhead (e.g., administration, depreciation, and utilities). For the years ended September 30, 2018 and 2017, these components of charity care costs totaled \$3,351,000 and \$6,541,000, respectively.

See Note 10 for additional disclosure related to benefits for the broader community and support of governmental health care programs.

City of Hope

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Performance Indicator

Management considers changes in net assets to be the performance indicator.

Unrestricted Net Assets

A rollforward of unrestricted net assets controlling and non-controlling for the years ended September 30, 2018 and 2017 is as follows (amounts in thousands):

	Controlling Interests	Non- Controlling Interests	Total
Beginning balance at September 30, 2016	\$ 2,395,357	\$ –	\$ 2,395,357
Excess of revenues and other increases over expenses	372,189	–	372,189
Inherent contribution from Affiliation	20,947	–	20,947
Balance at September 30, 2017	2,788,493	–	2,788,493
Excess of revenues and other increases over expenses	333,388	189	333,577
Contributed capital, non-controlling interest	–	34,911	34,911
Balance September 30, 2018	\$ 3,121,881	\$ 35,100	\$ 3,156,981

Derivative and Hedging Instruments

City of Hope is required to recognize all derivatives at fair value in the statements of financial position. At September 30, 2018 and 2017, derivative instruments consisted of two interest rate swap agreements with a total notional amount of \$65,000,000 (see Note 5). Interest rate swap agreements are entered into to manage interest rate risk. The derivatives are not designated as effective hedges and are adjusted to fair value in the consolidated statements of activities, above the performance indicator.

City of Hope

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Royalty and Licensing Revenue

City of Hope receives royalties from Genentech based on Genentech's revenues in the previous quarter from sales of its own drugs, as well as from royalties and other amounts paid by its licensees. Royalty revenue is recognized when received. Information from Genentech or its licensees regarding the amount of royalty revenue is not available until the amounts are actually received, usually one quarter in arrears. During 2018 and 2017, City of Hope received and recognized royalty and licensing revenue totaling \$500,370,000 and \$398,096,000, respectively, primarily from sales of drugs by Genentech and other licensees of monoclonal antibodies, including Rituxan, Herceptin, Avastin, Humira, and others using technology developed at the Institute and covered by the Cabilly patents. The Cabilly patents, as further defined in Note 9, are expiring during the first quarter of fiscal year 2019, with some royalty and licensing revenue anticipated to continue into fiscal year 2020.

City of Hope has entered into various licensing agreements, whereby equity interests in the licensee is received as compensation. The stock and membership units related to these agreements are recorded at fair value.

Investments

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the consolidated statements of financial position. These equity and debt securities are designated as trading securities as the investments are externally managed within the guidelines of the City of Hope investment policy. Fair value is established based on quoted prices from recognized security exchanges. Management determines the appropriate classification as either trading or other-than-trading for all equity and debt securities at the date of purchase and reevaluates such designations at each statement of financial position date. Accordingly, the change in unrealized gains and losses on investments is reported within changes in net assets in the consolidated statements of activities. Management considers the settlement date to be the valuation date when investments are purchased and sold.

Investment income or loss on equity and debt securities included in temporarily or permanently restricted net assets (including realized gains and losses on investments, interest, and dividends) is reported in unrestricted revenues and other increases unless the income or loss is restricted by the donor or by law.

City of Hope

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

City of Hope's alternative investments consist of limited partnerships and limited liability companies that seek to limit the effect of downward market swings on the portfolio and are not restricted to any particular asset class. Some alternative investments invest in other similar partnerships or funds and employ a "fund of funds" strategy, while other alternative investments have specific industry focus in their investment assets. At an investment manager's direction, these alternative investments may invest in both registered and non-registered securities in the U.S. and globally, with exposure to both emerging and developed markets. These entities employ a range of investment strategies including, but not limited to, long/short equity positions, derivatives, forward and futures contracts, and currency hedges. City of Hope also invests in private equity and private real asset funds that may be structured as drawdown funds, to which City of Hope has committed to fund future capital calls as the investment opportunities develop over the initial investment period established by the fund managers. As of September 30, 2018 and 2017, based upon most recent available information, the outstanding unfunded private equity and private real asset commitments total \$388,424,000 and \$313,544,000, respectively.

City of Hope's alternative investments include equity commingled funds that invest primarily in marketable securities. These funds are subject to certain notice requirements, but can be liquidated at least monthly.

City of Hope's hedge fund investments consist of direct and multi-manager hedge fund "fund of funds" investments, which implement a range of alternative investment strategies, including, but not limited to, long or short equity, credit, and other strategies. Investments in hedge funds have limited liquidity since shares or interests in the hedge funds are not freely transferable and are subject to various lock-up periods, redemption fees, and notice requirements. In addition, the hedge funds typically reserve the right to reduce or suspend redemptions (gating event) and to satisfy redemptions by making distributions in kind, under certain circumstances. Additionally, hedge funds may hold, directly or indirectly, side-pocket investments where no redemptions are permitted until such investments are liquidated or deemed realized. Redemption clauses range from monthly to quarterly and annually with various notice requirements between 30 and 90 days.

City of Hope's private equity investments consist of direct and private equity fund of funds investments, including private equity buyout, venture capital, mezzanine, and secondary private equity funds. These private equity investments typically have investment terms greater than ten years. City of Hope may not withdraw, sell, assign, or transfer its interests in the private equity funds except under very limited circumstances, subject to consent by the general partners of the funds.

City of Hope

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

City of Hope's real assets investments consist of 26 investment funds – one fund that invests in timberland properties, two funds that invest in global real estate investment trusts securities, four funds that invest in real estate operating company securities, nine funds that invest in distressed real estate, six energy funds, three fund of funds, and one fund that invests in Master Limited Partnerships. The investment terms of the timberland, distressed real estate, and energy funds are typically greater than ten years and City of Hope may not withdraw or sell, assign, or transfer its interests in these funds except in certain very limited circumstances, subject to consent by the general partners of the funds.

City of Hope accounts for its ownership interests in alternative investments at fair value, under which the net asset value (NAV) is used as a practical expedient to fair value in the accompanying consolidated statements of financial position and its changes in fair value and share of earnings are included in investment income in the consolidated statements of activities. Ownership interest in these funds ranges from 0.01% to 27.92% as of September 30, 2018.

Recent Accounting Pronouncements

In May 2014, the FASB issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers*, which requires the recognition of revenue for the transfer of goods or services equal to the amount that it expects to be entitled to receive for those goods or services. ASU 2014-09 is effective for annual periods beginning after December 15, 2017. Effective October 1, 2018, City of Hope adopted the provisions of the standard using the modified retrospective method. City of Hope has performed an initial assessment to identify the potential areas of impact that this new revenue recognition standard will have on its consolidated financial statements. The standard is a single comprehensive principles-based standard through the application of a five-step process. The adoption of the provisions of this ASU has no impact on City of Hope's current or historical financial position, results of operations or cash flows and management does not believe it will significantly impact the amount or timing of revenue recognition prospectively.

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*, which amends the accounting and disclosures of financial instruments, including a provision that requires equity investments (except for investments accounted for under the equity method of accounting) to be measured at fair value, with changes in fair value recognized in current earnings. ASU 2016-01 is effective for interim and annual periods beginning after December 15, 2018. City of Hope is evaluating the effect of this standard on the consolidated financial statements.

City of Hope

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*, which amends the existing accounting standards for lease accounting, including requiring lessees to recognize most leases on their balance sheets and making targeted changes to lessor accounting. The new standard, effective on October 1, 2019, required a modified retrospective transition approach for all leases existing at, or entered into after, the date of initial application. In July 2018, the FASB issued ASU 2018-08, *Leases (Topic 842): Targeted Improvements*. This guidance simplifies transition requirements, which allows for an option to apply the transition provisions of the new standard at its adoption date instead of at the earliest comparative period presented in its financial statements. It also provides a practical expedient for the separation of non-lease components from lease components. City of Hope is considering the impact of the transition provisions on its October 1, 2019 adoption date and whether to elect the practical expedient for the separation of non-lease components from lease components. The application of this new guidance is expected to result in the recording of material new lease related assets and liabilities on the balance sheet in accordance with its provisions.

In August 2016, the FASB issued ASU 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements for Not-for-Profit Entities*, which will require not-for-profit entities to revise financial presentation to include net asset classifications and provide quantitative and qualitative information as to available resources and management of liquidity and liquidity risk, information on investment expenses and returns, and the presentation of operating cash flows. The standard aims to help the reader of the financial statements to better understand the financial position of the organization and enhance consistency among similar organizations. ASU 2016-14 is effective for annual periods beginning after December 15, 2017. City of Hope is evaluating the effect of this standard on the consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash*, which requires among other things, restricted cash and cash equivalents to be included with cash and cash equivalents on the statement of cash flows. ASU 2016-18 is effective for annual periods beginning after December 15, 2017. City of Hope is evaluating the effect of this standard on the consolidated financial statements.

In January 2017, the FASB issued ASU 2017-01, *Business Combinations: (Topic 805) Clarifying the Definition of a Business*, which seeks to clarify the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The definition of a business affects many

City of Hope

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

areas of accounting, including acquisitions, disposals, goodwill, and consolidation. ASU 2017-01 is effective for annual periods beginning after December 15, 2017. City of Hope is evaluating the effect of this standard on the consolidated financial statements.

Reclassifications

Certain reclassifications were made to the 2017 accompanying consolidated financial statements to conform to the 2018 presentation. These reclassifications had no impact on the changes in net assets or excess of revenues over expenses previously reported and are not considered material to the consolidated financial statements of City of Hope.

3. California Hospital Fee Program

The State of California enacted legislation for a hospital fee program to fund certain Medi-Cal coverage expansions. The program charges hospitals a quality assurance fee that is used to obtain federal matching funds for Medi-Cal with the proceeds redistributed as supplemental payments to California hospitals that treat Medi-Cal patients. There are two hospital fee programs that had activity during 2017 and 2018; a 36-month hospital fee program covering the period from January 1, 2014 through December 31, 2016, and a 30-month hospital fee program covering the period from January 1, 2017 through June 30, 2019. Historically, the Center recognized revenue and expense upon approval of the program. During 2018, the Center determined that, for all hospital fee programs through fiscal year 2018, the supplemental payments met all criteria related to revenue recognition and the quality assurance fees are both probably and estimable. Accordingly, all related supplemental payments, both received and receivable have been recognized as net patient service revenues and related quality assurance fees have been recognized as hospital provider fee expenses as of September 30, 2018.

The Center has also entered into various enforceable pledge agreements with the California Health Foundation and Trust (CHFT), agreeing to make contributions to the CHFT based on a pre-described calculation methodology. These funds will be used by CHFT to support charitable activities at various independent hospitals and hospital/health systems in California, including measures to alleviate distortions, interruptions, and disparities potentially resulting from short-term changes in government health care reimbursement programs, including the hospital fee to be imposed on hospitals under the Program.

City of Hope

Notes to Consolidated Financial Statements (continued)

3. California Hospital Fee Program (continued)

For the years ended September 30, 2018 and 2017, the Center recognized \$149,981,000 and \$21,321,000, respectively, in net patient service revenues from the Program in the accompanying consolidated statements of activities. Additionally, the Center recognized \$40,836,000 and \$7,604,000, respectively, as expenses from the Program, which has been reflected in program services in the accompanying consolidated statements of activities. Of the total recognized revenue and expense during the year ended September 30, 2018, \$3,000,000 and \$5,728,000, respectively, was from the 36-month hospital fee program and \$146,981,000 and \$35,108,000, respectively, was from the 30-month hospital fee program.

As of September 30, 2018 and 2017, \$47,306,000 and \$20,905,000, respectively, is included in grants and other receivables and \$9,478,000 and \$404,000, respectively, is included in accounts payable and accrued liabilities in the accompanying consolidated statements of financial position.

4. Fair Value of Financial Instruments

The consolidated statements of financial position include the following financial instruments: cash and cash equivalents, patient accounts receivable, grants and other receivables, short- and long-term investments, prepaid and other, accounts payable and accrued liabilities, estimated amounts due to/from third-party payors, interest rate swaps, annuity and split-interest agreement obligations and long-term debt. City of Hope considers the carrying amounts of current assets and liabilities (except for investment securities, which are carried at fair value, as described in Note 2) in the consolidated statements of financial position to approximate the fair value of these financial instruments, because of the relatively short period of time between origination of the instruments and their expected realization. The carrying amount of tax-exempt and taxable long-term financing for City of Hope was \$932,301,000 and \$638,978,000, with a total fair value of \$997,970,000 and \$753,652,000 as of September 30, 2018 and 2017, respectively (Level 2 in the fair value hierarchy).

City of Hope

Notes to Consolidated Financial Statements (continued)

4. Fair Value of Financial Instruments (continued)

As defined by ASC 820, *Fair Value Measurement*, fair value is based on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In order to increase consistency and comparability in fair value measurements, a fair value hierarchy was established that prioritizes observable and unobservable inputs used to measure fair value into three broad levels, which are described below:

- Level 1: Quoted prices (unadjusted) in active markets that are accessible at the measurement date for assets or liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.
- Level 2: Observable prices that are based on inputs not quoted on active markets, but corroborated by market data.
- Level 3: Unobservable inputs are used when little or no market data is available. The fair value hierarchy gives the lowest priority to Level 3 inputs.

Assets and liabilities measured at fair value are based on one or more of three valuation techniques as identified in the tables below. Where more than one technique is noted, individual assets or liabilities were valued using one or more of the noted techniques. The valuation techniques are as follows:

- (a) *Market approach*. Prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities.
- (b) *Cost approach*. Amount that would be required to replace the service capacity of an asset (replacement cost).
- (c) *Income approach*. Techniques to convert future amounts to a single present amount based on market expectations (including present value techniques, option-pricing, and excess earnings models).

In determining fair value, City of Hope utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible, as well as considers counterparty credit risk in its assessment of fair value. The fair value of annuity and split-interest obligations has been determined using present value techniques based on mortality

City of Hope

Notes to Consolidated Financial Statements (continued)

4. Fair Value of Financial Instruments (continued)

tables and discount rates that are consistent with Internal Revenue Service published rates and the American Council on Gift Annuities. The fair value of pledges considers credit risk, which is estimated based on management's assessment of the collectability of pledges receivable.

City of Hope uses interest rate swaps to manage interest rate risk associated with floating-rate debt. The valuation of these instruments is determined using widely accepted valuation techniques, including discounted cash flow analysis on the expected cash flows of each derivative. This analysis reflects the contractual terms of the derivatives, including the period of maturity, and uses observable market-based inputs, including interest rate curves and implied volatilities. The fair values of interest rate swaps are determined using the market standard methodology of netting the discounted future fixed cash payments and the discounted expected variable cash receipts. The variable cash receipts are based on an expectation of future interest rates (forward curves) derived from observable market interest rate curves. City of Hope incorporated credit valuation adjustments to appropriately reflect both its own nonperformance risk and the respective counterparty's nonperformance risk in the fair value measurements.

Although City of Hope has determined that the majority of the inputs used to value its derivatives fall within Level 2 of the fair value hierarchy, the credit valuation adjustments associated with its interest rate swaps utilize Level 3 inputs, such as estimates of current credit spreads to evaluate the likelihood of default by itself and its counterparties. However, as of September 30, 2018 and 2017, City of Hope has assessed the significance of the impact of the credit valuation adjustments on the overall valuation of their derivative positions and has determined that the credit valuation adjustments are not significant to the overall valuation of its derivatives. As a result, City of Hope has determined that their derivative valuations in their entirety are classified as Level 2 in the fair value hierarchy.

City of Hope

Notes to Consolidated Financial Statements (continued)

4. Fair Value of Financial Instruments (continued)

City of Hope's assets and liabilities, measured at fair value on a recurring basis as of September 30 aggregated by the level in the fair value hierarchy, are included in cash equivalents, investments, other long-term assets, annuity and split-interest agreement obligations, and interest rate swaps in the consolidated statements of financial position and are as follows (amounts in thousands):

2018	Investments at Fair Value				Investments at Net		Valuation Technique (a,b,c)
	Level 1	Level 2	Level 3	Fair Value	Asset Value	Total	
Investments:							
U.S. government and agency obligations	\$ -	\$ 80,996	\$ -	\$ 80,996	\$ -	\$ 80,996	a,b
Corporate obligations	-	264,026	-	264,026	-	264,026	a,b
Asset-backed obligations	-	150,633	-	150,633	-	150,633	a,b
Mortgage-backed obligations	-	125,779	-	125,779	-	125,779	a,b
Marketable securities	740,032	-	-	740,032	-	740,032	a
Public real assets	231,812	-	-	231,812	-	231,812	a
Municipal obligations	-	1,766	-	1,766	-	1,766	a
Preferred stock	-	-	612	612	-	612	c
Hedge funds	-	-	-	-	297,046	297,046	
Equity commingled funds	-	-	-	-	891,365	891,365	
Private equity funds	-	-	-	-	202,391	202,391	
Private real assets	-	-	-	-	174,586	174,586	
Cash equivalents	256,917	-	-	256,917	-	256,917	a
Total investments	\$ 1,228,761	\$ 623,200	\$ 612	\$ 1,852,573	\$ 1,565,388	\$ 3,417,961	
Other long-term assets:							
Marketable securities	\$ 25,855	\$ -	\$ -	\$ 25,855	\$ -	\$ 25,855	a
Cash equivalents	\$ 454	\$ -	\$ -	\$ 454	\$ -	\$ 454	a
Total investments and other long-term assets	\$ 1,255,070	\$ 623,200	\$ 612	\$ 1,878,882	\$ 1,565,388	\$ 3,444,270	
Liabilities at fair value:							
Annuity and split-interest obligations							
			Level 1	Level 2	Level 3	Total	
			\$ -	\$ -	\$ 20,464	\$ 20,464	c
Interest rate swaps			-	6,548	-	6,548	a,b
Total liabilities			\$ -	\$ 6,548	\$ 20,464	\$ 27,012	

City of Hope

Notes to Consolidated Financial Statements (continued)

4. Fair Value of Financial Instruments (continued)

2017	Investments at Fair Value				Investments at Net		Valuation Technique (a,b,c)
	Level 1	Level 2	Level 3	Fair Value	Asset Value	Total	
Investments:							
U.S. government and agency obligations	\$ -	\$ 51,835	\$ -	\$ 51,835	\$ -	\$ 51,835	a,b
Corporate obligations	-	91,359	-	91,359	-	91,359	a,b
Marketable securities	741,043	-	-	741,043	-	741,043	a
Public real assets	234,073	-	-	234,073	-	234,073	a
Municipal obligations	-	1,967	-	1,967	-	1,967	a
Preferred stock	-	-	62	62	-	62	c
Hedge funds	-	-	-	-	443,784	443,784	
Equity commingled funds	-	-	-	-	803,023	803,023	
Private equity funds	-	-	-	-	150,510	150,510	
Private real assets	-	-	-	-	175,582	175,582	
Cash equivalents	161,018	-	-	161,018	-	161,018	a
Total investments	\$ 1,136,134	\$ 145,161	\$ 62	\$ 1,281,357	\$ 1,572,899	\$ 2,854,256	
Other long-term assets:							
Marketable securities	\$ 21,428	\$ -	\$ -	\$ 21,428	\$ -	\$ 21,428	a
Cash equivalents	\$ 433	\$ -	\$ -	\$ 433	\$ -	\$ 433	a
Total investments and other long-term assets	\$ 1,157,995	\$ 145,161	\$ 62	\$ 1,303,218	\$ 1,572,899	\$ 2,876,117	
Liabilities at fair value:							
			Level 1	Level 2	Level 3	Total	
Annuity and split-interest obligations			\$ -	\$ -	\$ 18,580	\$ 18,580	c
Interest rate swaps			-	10,266	-	10,266	a,b
Total liabilities			\$ -	\$ 10,266	\$ 18,580	\$ 28,846	

Other long-term assets are marketable securities related to a City of Hope 457(b) Plan that is funded by plan participants.

City of Hope

Notes to Consolidated Financial Statements (continued)

4. Fair Value of Financial Instruments (continued)

The table below sets forth a summary of changes in fair value of the Level 3 assets and liabilities for the years ended September 30, 2018 and 2017 (amounts in thousands):

	<u>Assets</u>	<u>Liabilities</u>
Beginning balance at September 30, 2016	\$ 62	\$ 17,264
Additions	—	867
Investment activity, adjustments, maturities	—	196
Distributions	—	(1,020)
Change in fair value	—	1,273
Beginning balance at September 30, 2017	62	18,580
Additions	550	3,739
Investment activity, adjustments, maturities	—	605
Distributions	—	(1,355)
Change in fair value	—	(1,105)
Ending balance at September 30, 2018	<u>\$ 612</u>	<u>\$ 20,464</u>

The following reconciles fair value amounts to the consolidated statements of financial position as of September 30 (amounts in thousands):

	<u>2018</u>	<u>2017</u>
Cash and cash equivalents	\$ 377,571	\$ 212,067
Investments, current	1,526,106	1,191,963
Self-insurance trust funds	3,765	3,352
Investments held for long-term purposes	302,822	313,812
Board-designated assets	884,127	815,638
Donor-restricted investments	518,251	442,913
	3,612,642	2,979,745
Less: investment at net asset value	(1,565,388)	(1,572,899)
Less: amounts held in operating cash	(194,681)	(125,489)
Plus: amounts in other long-term assets	26,309	21,861
Investments at fair value	<u>\$ 1,878,882</u>	<u>\$ 1,303,218</u>

City of Hope

Notes to Consolidated Financial Statements (continued)

4. Fair Value of Financial Instruments (continued)

Board-designated assets include funds either set aside as institutionally designated endowments or established by the Board of Directors for future research, program services, and capital expenditures for City of Hope.

Investment income in the consolidated statements of activities includes changes in fair value of equity interests in alternative investments. For the years ended September 30, 2018 and 2017, these changes in fair value of equity interests totaled a gain of \$125,000 and \$49,600,000, respectively.

5. Long-Term Debt

The following is a summary of City of Hope's long-term debt as of September 30 (amounts in thousands):

	2018	2017
City of Hope, 3.75% to 5.00% fixed rate Tax-Exempt Revenue Bonds Series 2012A, originally \$234,635, issued through the California Health Facilities Financing Authority, with varying maturities annually on November 15, 2014 through November 15, 2039. Interest payable semiannually on May 15 and November 15 (Series 2012A Revenue Bonds).	\$ 213,400	\$ 219,115
City of Hope, 5.623% fixed rate, Taxable Direct Obligation Notes, originally \$350,000. Interest payable semiannually on May 15 and November 15, principal payment due in full on November 15, 2043 (Series 2013 Notes).	350,000	350,000
City of Hope, Tax-Exempt Variable Rate Revenue Bonds Series 2017A, originally \$32,680, issued through the California Health Facilities Financing Authority. Interest payable monthly, principal payments annually beginning on November 15, 2039 through November 15, 2042 (Series 2017A Revenue Bonds).	32,680	32,680

City of Hope

Notes to Consolidated Financial Statements (continued)

5. Long-Term Debt (continued)

	<u>2018</u>	<u>2017</u>
City of Hope, Tax-Exempt Variable Rate Revenue Bonds Series 2017B, originally \$32,680, issued through the California Health Facilities Financing Authority. Interest payable monthly, principal payments annually beginning on November 15, 2039 through November 15, 2042 (Series 2017B Revenue Bonds).	\$ 32,680	\$ 32,680
City of Hope, 4.378% fixed rate, Taxable Direct Obligation Notes, originally \$300,000. Interest payable semiannually on February 15 and August 15, principal payment due in full on August 15, 2048 (Series 2018 Notes).	300,000	—
TGen, 3.27% to 4.22% fixed rate notes. Principal and interest payable monthly through April 2020 (TGen Notes).	2,241	2,903
TGen, 2% fixed rate notes. Principal and interest payable annually through 2022 (TGen Notes).	1,300	1,600
Assets constructed by landlord	—	8,194
Capital lease obligations:		
Equipment	2,270	2,657
Facilities	70,832	29,430
	<u>1,005,403</u>	<u>679,259</u>
Less: current maturities of long-term debt and capital lease obligations	(13,051)	(11,650)
Less: unamortized bond issue costs	(2,934)	(2,004)
Less: unamortized discount	(5,313)	(3,545)
Plus: unamortized premium	19,705	21,351
	<u>\$ 1,003,810</u>	<u>\$ 683,411</u>

City of Hope

Notes to Consolidated Financial Statements (continued)

5. Long-Term Debt (continued)

Long-term debt maturities and capital lease obligations as of September 30, 2018, and payments for the subsequent years are as follows (amounts in thousands):

2019	\$	13,051
2020		12,830
2021		12,518
2022		12,839
2023		13,180
Thereafter		940,985
		<u>\$ 1,005,403</u>

Series 2012 Revenue Bonds (Tax-Exempt) – In November 2012, pursuant to a Master Trust Indenture (MTI), the Obligated Group issued \$234,635,000 of Tax-Exempt Series 2012A fixed rate Revenue Bonds (Series 2012A Revenue Bonds), \$32,500,000 of Tax-Exempt Series 2012B Variable Rate Revenue Bonds (Series 2012B Revenue Bonds), and \$32,500,000 of Tax-Exempt Series 2012C Variable Rate Revenue Bonds (Series 2012C Revenue Bonds) through the California Health Facilities Financing Authority. The Series 2012A Revenue Bonds were issued at a premium totaling \$29,887,000. The obligations issued under the MTI, including those securing the Series 2012 Revenue Bonds, are secured by a gross receivables pledge.

During 2017, the Obligated Group refunded its Series 2012B and 2012C revenue bonds. See Series 2017 Notes (Tax-Exempt) below.

Series 2013 Notes (Taxable) – In July 2013, City of Hope, as representative of the Obligated Group, issued \$350,000,000 of Series 2013 fixed rate Direct Obligation Notes (the Series 2013 Notes) under the MTI. The proceeds from the Series 2013 Notes are used for the Obligated Group's capital needs in furtherance of the implementation of the Obligated Group's strategic plan. The Series 2013 Notes are secured by a gross receivables pledge

Series 2017 Notes (Tax-Exempt) – In February 2017, City of Hope as representative of the Obligated Group, refunded all of the Series 2012B in the amount of \$32,500,000 and Series 2012C in the amount of \$32,500,000 California Health Facilities Financing Authority Variable Rate Revenue Bonds with two new issues through the California Health Facilities Financing Authority, Variable Rate Revenue Notes Series 2017A in the amount of \$32,680,000 and Series 2017B in the amount of \$32,680,000. The Series 2017 Notes were directly purchased by a commercial bank and

City of Hope

Notes to Consolidated Financial Statements (continued)

5. Long-Term Debt (continued)

have the same maturity and approximate principal amortization as the refunded Series 2012B and Series 2012C Revenue Bonds and bear interest based on 70% of one-month of the London Interbank Offered Rate (LIBOR) plus a spread.

Series 2018 Notes (Taxable) – In May 2018, City of Hope as representative of the Obligated Group, issued \$300,000,000 of Series 2018 fixed rate Direct Obligation Notes (the Series 2018 Notes) under the MTI. The proceeds from the Series 2018 Notes are used for the Obligated Group's capital needs in furtherance of the implementation of the Obligated Group's strategic plan, including geographic expansion, addressing patient capacity, informatics, developing precision medicine and funding research to support the development of innovative treatments. The Series 2018 Notes are secured by a gross receivables pledge.

TGen Notes – TGen Notes are comprised of notes payable with a bank for laboratory equipment and a promissory note for the purchase of the outstanding 50% interest in a subsidiary company. The TGen Notes for laboratory equipment are secured by the equipment financed.

Capital Lease Obligations – City of Hope has entered into various capital lease agreements for equipment and program and administrative facilities. Assets are capitalized using interest rates commensurate with City of Hope's incremental borrowing rate.

On October 3, 2017, TGen entered into a long-term capital lease agreement to purchase the building where its primary operations are conducted in Phoenix, Arizona through a subsidiary limited liability company (the TGen LLC). The aggregate lease payments that TGen will be obligated to make under the agreement are approximately \$67,500,000, beginning in October 2017 through April 2037. Additionally, under the lease agreement the TGen LLC will receive future sublease income from tenants in the amount of \$14,896,000 through December 2034.

In order to secure its obligation under the long-term capital lease agreement, the TGen LLC purchased an irrevocable standby letter of credit in the amount of up to \$25,000,000 for the benefit of the lessor. The standby letter of credit is guaranteed by City of Hope and it will renew annually based on a pre-agreed amortization schedule unless terminated with a 60-day notice prior to the annual anniversary date by the lender. Unless it has expired earlier, this letter of credit shall finally expire on October 1, 2035.

City of Hope

Notes to Consolidated Financial Statements (continued)

5. Long-Term Debt (continued)

Assets Constructed by Landlord – Under ASC 840, *Leases*, a build-to-suit arrangement exists when a lessee, among other things, is financially involved in the construction of certain structural improvements prior to the commencement of the lease. Under both of these lease agreements discussed below, the Foundation will be financially involved in the construction of non-normal tenant improvements of the building, which results in the Foundation being considered the owner of the assets during the construction period. As construction of the medical office buildings progresses, the Foundation will record the costs paid by the landlord to construct the building as construction in progress and a related long-term financing obligation.

Upon completion of construction, projects will be evaluated for sales lease-back treatment and, should the criteria not be met, the Foundation will carry and amortize the financing obligation to the extent that lease payments are applied to the liability and depreciate the building over the estimated useful life.

In April 2016, the Foundation entered into an affiliation agreement with Providence Little Company of Mary Medical Center (PLCMMC). As one of several components of the affiliation, PLCMMC and the Foundation entered into a 15-year lease, pursuant to which the Foundation will lease space in a medical office building to be constructed by PLCMMC. The lease agreement is subject to build to suit accounting under ASC 840, *Leases*. Upon completion of construction of this building in 2018, the Foundation reevaluated the lease agreement under sales lease-back guidance and it was determined that the lease qualifies for sales lease-back treatment. As of September 30, 2018, the Foundation has derecognized \$43,427,000 in property, plant and equipment, \$8,194,000 in long-term debt and \$35,233,000 in other long term liabilities. The Foundation began operating a multi-disciplinary community cancer center at this location in August 2018.

In December 2016, the Foundation entered into a 15-year lease agreement with San Antonio Regional Hospital (SARH) for an outpatient cancer center to be owned and operated by the Foundation. The lease agreement provides for the design and construction of a medical office building by SARH. The lease agreement is subject to build to suit accounting under ASC 840, *Leases*. As of September 30, 2018, the Foundation has recorded \$10,891,000 in construction in progress and a related other long-term liability. Upon completion of construction during 2019, the Foundation will evaluate the lease under sales lease back criteria to determine whether the Foundation will continue to carry and amortize the construction costs over the life of the lease. The Foundation expects to begin operating a multi-disciplinary community cancer center at this location in 2019.

City of Hope

Notes to Consolidated Financial Statements (continued)

5. Long-Term Debt (continued)

Interest Rate Swap Transactions – In November 2012, the Obligated Group entered into two interest rate swap contracts to synthetically convert the Series 2012B and Series 2012C Revenue Bonds from a variable rate to a fixed rate of 2.715% and 2.720%, respectively. The Obligated Group receives a floating rate equal to 70% of the USD-LIBOR-BBA for both Series 2012B and Series 2012C Revenue Bonds. The swaps were not designated as cash flow hedges, so the changes in fair value are recorded within program and supporting services expenses in the accompanying consolidated statements of activities, totaling an expense reduction of \$3,718,000 and \$6,686,000 for the years ended September 30, 2018 and 2017, respectively. The effect of counterparty payments and receipts on interest expense was an expense increase of \$976,000 and \$1,356,000 for the years ended September 30, 2018 and 2017, respectively.

Financial Covenants – Under the Series 2012 Revenue Bonds, the Series 2013 Notes, the Series 2017 Notes and the Series 2018 Notes, the Obligated Group must maintain certain financial covenants. The Obligated Group was in compliance with the respective covenants at September 30, 2018.

Line of Credit – City of Hope maintains a consolidated unsecured revolving bank line of credit in the amount of \$50,000,000, which expires on June 30, 2019. Interest is charged at LIBOR plus 0.75%. As of September 30, 2018 and 2017, there was no outstanding balance on the line of credit.

TGen maintains an unsecured revolving line of credit in the amount of \$6,000,000, which expires on November 20, 2018 and will not be renewed. As of September 30, 2018 and 2017, there was no outstanding balance on the line of credit.

6. City of Hope Medical Foundation

City of Hope has established a nonprofit medical foundation in order to create a more integrated health care delivery system, to continue to enhance the quality of the clinical care provided to its patients and the research it conducts, and to respond to federal health care reform legislation.

The Foundation has entered into a five-year professional services agreement with the City of Hope Medical Group (COHMG), an unconsolidated medical group. Under the terms of the professional services agreement, COHMG physicians provide exclusive patient care services and academic services, such as teaching, administrative, and research services, to the Foundation. As part of City of Hope's goal of creating greater integration and coordination of City of Hope's patient care, research, and educational services, the Foundation provides for or arranges for the provision of certain patient care and on-call coverage services and teaching, administrative, and research

City of Hope

Notes to Consolidated Financial Statements (continued)

6. City of Hope Medical Foundation (continued)

services for the operations and activities of the Center pursuant to an agreement between the Foundation and the Center. The professional fees associated with the contract between the Foundation and the Center are eliminated in consolidation.

Pursuant to the professional services agreement, COHMG assigns to the Foundation the right to bill and collect for professional services rendered by COHMG physicians and other professional employees, and the Foundation contracts directly with payors in connection with the provision of patient care services. Accordingly, net patient service revenues for the Foundation include amounts for services provided by COHMG physicians on behalf of the Foundation.

7. Acquisitions and Affiliations

City of Hope accounts for acquisitions and affiliations in accordance with ASC 958-805, *Not-for-Profit Entities Business Combinations*, in determining the appropriate accounting treatment for acquisitions and affiliations. Under ASC 958-805, business combinations are classified as either a merger or an acquisition, which results in differing accounting treatment.

Effective November 17, 2016, City of Hope and TGen entered into an Affiliation Agreement (Agreement), pursuant to which City of Hope became the sole corporate member of TGen. Based on ASC 958-805, the Affiliation is classified as an acquisition rather than a merger. The accounting for acquisitions requires extensive use of estimates and judgments to measure the fair value of the identifiable tangible and intangible assets acquired. Fair value is estimated at the acquisition date and is measured using the income and market approaches with significant unobservable inputs. City of Hope engaged an independent third-party valuation firm to assist in determining the fair value of identifiable intangible assets. City of Hope believes that the fair values assigned to the assets acquired and liabilities assumed are based on reasonable assumptions. However, actual values may differ and unanticipated events and circumstances may occur.

City of Hope

Notes to Consolidated Financial Statements (continued)

7. Acquisitions and Affiliations (continued)

The Affiliation did not involve consideration and resulted in an excess of assets acquired over liabilities assumed which has been recorded as a contribution to City of Hope of \$46,419,000. City of Hope recognized the following tangible and intangible assets acquired and liabilities assumed in connection with the Affiliation based upon their estimated fair values at the transaction date (amounts in thousands):

Cash and cash equivalents	\$ 10,598
Accounts receivable	5,037
Prepaid and other assets	4,312
Property and equipment	8,251
Favorable leasehold interests	590
Trade name	4,000
Intellectual property research and development (IPR&D)	4,600
Donor-restricted assets	25,472
Other long-term assets	2,701
Current liabilities	(12,586)
Long-term debt	(2,261)
Other non-current liabilities	(4,295)
Total identifiable net assets assumed	<u>\$ 46,419</u>

Effective March 30, 2018, the Foundation closed a transaction with Vantage Oncology Treatment Centers, LLC and certain of its affiliates (Vantage) and Valley Radiotherapy Associates Medical Group, Inc. (VRA) related to nine freestanding radiation therapy centers in Southern California that were managed by Vantage and operated by VRA prior to the closing. The Foundation and Vantage formed a new joint venture company Southern California Radiation Oncology, LLC (SCRO) (owned 50.1% by the Foundation and 49.9% by Vantage), to manage and provide services to the nine centers. The Foundation evaluated the transaction under ASU 958-810, *Not-for-Profit Entities – Consolidation* and determined the Foundation has significant and substantive participating rights in the operations of SCRO. The rights of Vantage are substantively protective rights. SCRO contracts with various Vantage affiliates to provide most of these services. As the provider and operator of the centers, the Foundation has retained responsibility for providing certain categories of services at the centers. As part of the transaction, approximately 27 VRA physicians who provide services at the centers and at four hospital-based radiation oncology programs in Los Angeles and Orange counties joined the COHMG. The Foundation contributed \$23,494,000 to purchase its initial 50.1% ownership interest in the joint venture plus a previous

City of Hope

Notes to Consolidated Financial Statements (continued)

7. Acquisitions and Affiliations (continued)

investment in a 40% holding with a fair value of \$8,745,000, along with an initial working capital contribution in the amount of \$2,813,000 for a total investment in the joint venture of \$35,052,000. Vantage contributed tangible and intangible assets, including facility leases and equipment and \$2,802,000 in initial working capital for a total of \$34,911,000.

The following tangible and intangible assets acquired in connection with the joint venture were recorded as follows (amounts in thousands):

Cash and cash equivalents (initial working capital)	\$	5,615
Prepaid and other assets		388
Property and equipment		3,703
Trade name		430
Favorable leasehold interests		690
Goodwill		59,067
Other long-term assets		70
Total identifiable tangible and intangible assets	\$	<u>69,963</u>

The Foundation believes that the values assigned to the SCRO joint venture were based on reasonable assumptions. Under ASC Topic 350, *Intangibles – Goodwill and Other*, SCRO has adopted an annual measurement date of July 1 for the performance of goodwill impairment. Its first annual impairment was performed using a qualitative assessment on July 1, 2018 and no indicator of impairment was identified with respect to goodwill as September 30, 2018.

8. Intangible Assets and Other Technology

Intangible assets is comprised of trade names, electronic medical records, and favorable leasehold interests totaling \$15,173,000. Certain of these intangible assets are subject to amortization.

The accumulated amortization for intangible assets subject to amortization totaled \$9,106,000 and \$7,967,000, as of September 30, 2018 and 2017, respectively. City of Hope has recorded \$1,139,000 and \$1,272,000 of amortization and rent expense for acquired intangible assets during the years ended September 30, 2018 and 2017, respectively. Intangible assets are amortized on a

City of Hope

Notes to Consolidated Financial Statements (continued)

8. Intangible Assets and Other Technology (continued)

straight-line basis between seven and ten years. Future amortization of these intangibles subject to amortization is reflected below (amounts in thousands):

2019	\$	629
2020		491
2021		304
2022		113
2023		111
Thereafter		419
	\$	<u>2,067</u>

Other technology is comprised of IPR&D resulting from the Affiliation with TGen and totals \$4,600,000 as of September 30, 2018 and 2017. Under ASU Topic 350, *Intangibles – Goodwill and Other*, IPR&D is subject to annual impairment assessment, or more frequently if significant indicators of impairment exist. TGen has elected an annual measurement date of July 1 and performed a qualitative review for impairment of IPR&D and there was no indication of an impairment in value as of September 30, 2018.

9. Commitments and Contingencies

Leases

City of Hope has non-cancelable operating leases for office space and equipment that expire on various dates through 2072. As of September 30, 2018, future minimum payments required under these operating leases, are as follows (amounts in thousands):

2019	\$	13,510
2020		12,586
2021		11,924
2022		9,894
2023		8,466
Thereafter		98,158
	\$	<u>154,538</u>

Amounts above have not been reduced by sublease income totaling \$711,000 through 2021.

City of Hope

Notes to Consolidated Financial Statements (continued)

9. Commitments and Contingencies (continued)

Lease expense for the leases shown above and other month-to-month rental agreements totaled \$14,880,000 and \$14,167,000 in 2018 and 2017, respectively.

Litigation and Administrative Actions

From time to time, City of Hope is subject to claims arising in the ordinary course of business. In the opinion of management, with the exception of the matters discussed below, the ultimate resolution of legal proceedings and other claims currently pending will not have a material adverse effect on the consolidated financial position, statements of activities, or cash flows of City of Hope.

City of Hope has been engaged in various proceedings involving challenges to the validity of U.S. Patent No. 6,331,415 issued December 18, 2001, entitled “Methods of Producing Immunoglobulins, Vectors and Transformed Host Cells for Use Therein” (the Cabilly II patent) and U.S. Patent No. 7,923,221 entitled “Methods of Making Antibody Heavy and Light Chains Having Specificity for a Desired Antigen” (the Cabilly III patent, and together with Cabilly II patent, the Cabilly patents). Both of the Cabilly patents are co-owned by City of Hope and Genentech, and are set to expire in the first quarter of fiscal year 2019.

On August 22, 2017, City of Hope filed a lawsuit in the United States District Court for the Central District of California against Juno Therapeutics (Juno), a publicly traded bio-pharmaceutical company. The lawsuit related to an Exclusive License Agreement (ELA) under which City of Hope granted Juno a license to certain patent rights relating to cellular immunotherapies for cancer, and specifically CAR T cell therapy. City of Hope alleged that Juno failed to perform certain promises it made in the ELA relating to sublicensing, and asserted claims for breach of contract and declaratory judgment of material breach and breach of material terms of the ELA entitling City of Hope to terminate the ELA. On August 31, 2017, Juno filed counterclaims against City of Hope for breach of contract and for a declaratory judgment that Juno had not breached the ELA, and that City of Hope did not have a basis on which to terminate the ELA. On February 13, 2018, Juno was granted leave to amend to add an additional counterclaim for breach of contract. At a mediation on June 6, 2018, Juno and City of Hope resolved the dispute, and on July 9, 2018, the parties entered into an agreement documenting the terms of the settlement. Pursuant to the settlement agreement, the license to Juno was reinstated, COH consented to a sublicense to Celgene, which had recently completed its acquisition of Juno, and Juno made a payment to City of Hope. The financial terms of the settlement are confidential.

City of Hope

Notes to Consolidated Financial Statements (continued)

9. Commitments and Contingencies (continued)

On October 6, 2017, Amgen Inc. filed a lawsuit against Genentech, Inc. and City of Hope in the United States District Court (USDC) for the Central District of California, *Amgen Inc. v. Genentech, Inc. and City of Hope*, Case No. 2:17-cv-07349 GW, seeking a declaratory judgment of patent non-infringement, invalidity and unenforceability with respect to certain specified patents related to Genentech's antibody drug Avastin, including the Cabilly patents. On the same date, Genentech and City of Hope filed a lawsuit against Amgen in the USDC for the District of Delaware, *Genentech, Inc. and City of Hope v. Amgen Inc.*, Case No. 1:17-cv-1407, for patent infringement, declaratory judgment and additional relief relating to the patents-in-suit. On October 18, 2017, Genentech and City of Hope filed a second, related lawsuit, *Genentech, Inc. and City of Hope v. Amgen Inc.*, Case No. 1:17-cv-1471, in the USDC for the District of Delaware against Amgen for infringement, and declaratory judgment and additional relief. These cases arise from Amgen's application for FDA approval under the Biologics Price Competition and Innovation Act of 2009 (BPCIA) to commercialize a biosimilar copy of Avastin. On February 2, 2018, the USDC for the Central District of California dismissed the lawsuit filed by Amgen. The proceedings in Delaware are at a very early stage and the final outcome of the litigation cannot be determined at this time.

On November 11, 2017, Genentech and City of Hope filed a lawsuit against Pfizer Inc. in the USDC for the District of Delaware, *Genentech, Inc. and City of Hope v. Pfizer, Inc.*, Case No. 1:17-cv-01672-VAC, alleging patent infringement of certain specified patents related to Genentech's antibody drug Herceptin, including the Cabilly patents. The patent infringement action arises from Pfizer's application for FDA approval under the BPCIA to commercialize a biosimilar version of Herceptin. On December 4, 2018, pursuant to a negotiated resolution, the parties filed a stipulation dismissing without prejudice all claims and counter claims and the order dismissing the case was filed the same day.

On December 21, 2017, Genentech, Biogen, Inc. and City of Hope filed suit against Sandoz, Inc., Sandoz International GMBH, and Sandoz GMBH in the USDC for the District of New Jersey, *Genentech, Inc. and City of Hope v. Sandoz, Inc., et al.*, Case No. 1:17-cv-13507-RMB, alleging patent infringement of certain specified patents related to Genentech's antibody drug Rituxan, including the Cabilly patents. The patent infringement action arises from Sandoz's application for FDA approval under the PCIA to commercialize a biosimilar version of Rituxan. On November 2, 2018, Sandoz publicly announced that it was discontinuing its biosimilar program relating to Rituxan in the United States. On November 6, 2018, litigation counsel for Sandoz notified the Court of this development and requested a stay of all deadlines while the parties work toward filing a stipulated dismissal for the case in its entirety.

City of Hope

Notes to Consolidated Financial Statements (continued)

9. Commitments and Contingencies (continued)

On January 11, 2018, Celltrion, Inc., Celltrion Healthcare Co., Ltd, Teva Pharmaceuticals USA, Inc., and Teva Pharmaceuticals International GmbH (collectively, Celltrion) filed two suits against Genentech, Biogen, Inc., Hoffmann-La Roche Inc., and City of Hope in the USDC for the Northern District of California, *Celltrion, Inc. et al., v. Genentech, Inc. et al.*, for declaratory judgment of non-infringement and/or invalidity with respect to certain specified patents related to Genentech's antibody drugs Rituxan and Herceptin, respectively, including the Cabilly patents. These cases arose from Celltrion's application for FDA approval under the PBCIA to commercialize biosimilar versions of Rituxan and Herceptin. On June 1, 2018, the USDC for the Northern District of California dismissed these lawsuits. Those dismissals were appealed to the United States Court of Appeals for the Federal Circuit, and docketed July 16, 2018 as Case Nos. 18-2160 and 18-2161, respectively.

On January 12, 2018, Genentech, Biogen, Hoffmann-La Roche and COH filed two suits against Celltrion, one in the USDC for the District of New Jersey, *Genentech, Inc. et al. v. Celltrion, Inc. et al.*, Case No. 1:18-cv-00574-RMB-KMW, and the other in the USDC for the District of Delaware, Case No. 1:18-cv-000095-GMS, for patent infringement of certain specified patents, including the Cabilly patents, also arising from Celltrion's application for FDA approval of its biosimilar versions of Rituxan and Herceptin, respectively.

On June 21, 2018, Genentech and City of Hope filed a lawsuit against Amgen in the USDC for the District of Delaware, *Genentech, Inc. et al., v. Amgen, Inc.*, Case No. 1:18-cv-00924-GMS, alleging patent infringement of certain specified patents related to Genentech's antibody drug Herceptin, including the Cabilly patents. The patent infringement action arises from Amgen's application for FDA approval under the BPCIA to commercialize a biosimilar version of Herceptin.

On July 11, 2018, Genentech, City of Hope and Hoffmann-La Roche filed additional lawsuits against Celltrion in the USDC for Delaware and New Jersey, *Genentech, Inc. et al. v. Celltrion, Inc. et al.*, Case No. 1:18-cv-01025-GMS and Case No. 1:18-cv-11553-RMB-KMW, that are substantially similar to the lawsuits filed against Celltrion in the respective courts on January 12, 2018. Both were filed to ensure compliance with certain provisions of the BPCIA. On October 5, 2018, the USDC for Delaware and New Jersey entered stipulations between the parties to the *Celltrion* litigations relating to Rituxan for the dismissal of all claims and counterclaims based on the Cabilly patents, and for the dismissal of City of Hope from the cases.

City of Hope

Notes to Consolidated Financial Statements (continued)

9. Commitments and Contingencies (continued)

On September 4, 2018, Genentech and City of Hope filed a lawsuit against Samsung Bioepsis in the USDC for the District of Delaware, *Genentech, Inc. et al., v Samsung Bioepsis Co., Ltd.*, Case No. C.A. 18-1363-CFC, alleging patent infringement of certain specified patents related to Genentech's antibody drug Herceptin, including the Cabilly patents. The patent infringement action arises from Samsung Bioepsis' application for FDA approval under the BPCIA to commercialize a biosimilar version of Herceptin.

On November 7, 2018, in each of the pending *Amgen, Pfizer, Celltrion and Samsung Bioepsis* litigations relating to Herceptin, pursuant to the Delaware Court's Scheduling Orders entered therein, Genentech and City of Hope narrowed the scope of the cases relating to Herceptin and identified specific patents and claims to pursue further in the pending litigations. The Cabilly patents were not included in this list based on Genentech and City of Hope's understanding that Amgen, Pfizer, Celltrion and Samsung Bioepsis will not make, use, sell, offer for sale, or import its biosimilar products at issue in this action until after the expiration of these patents. Genentech and City of Hope reserved the right to assert these patents to the extent that Amgen, Pfizer, Celltrion or Samsung Bioepsis performs infringing acts before the expiry of the Cabilly patents.

If either Cabilly patents are ultimately declared invalid in any of the proceedings listed above, royalties under the two Cabilly patents could be significantly reduced or eliminated in the future, which could have a material adverse impact on the financial condition of the Obligated Group. However, any impact would be limited, as the Cabilly patents are expiring during the first quarter of fiscal year 2019, with some carryover revenue continuing through 2020.

Health Care Regulations

The Center and the Foundation are subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, governmental health care program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Federal laws prohibit submission of claims for reimbursement to the Medicare and Medicaid programs for services not rendered in accordance with applicable rules, laws, and regulations. Any overpayments received must be refunded to the government payor. Violation of these laws can result in substantial civil and criminal penalties and fines, including treble damages and mandatory penalties of up to \$11,000 per claim, as well as possible debarment from future participation in government health care programs. Management believes that the Center and the Foundation are presently in compliance with fraud and abuse laws, as well as other applicable government laws

City of Hope

Notes to Consolidated Financial Statements (continued)

9. Commitments and Contingencies (continued)

and regulations. While no material regulatory inquiries about past or present conduct have been made, compliance with such laws and regulations can be subject to future government review and interpretation, as well as regulatory actions unknown or unasserted at this time.

Capital Commitments (Unaudited)

As of September 30, 2018, the City of Hope has committed to spend approximately \$89,023,000 through 2019 for building renovations, multiple campus facility renovations, and various information technology projects.

10. Community Benefit Expense (Unaudited)

City of Hope supports a variety of programs and services that provide a direct benefit to its patients, as well as to the broader community. The primary categories of community benefit are as follows:

- Benefits for the Broader Community – Clinical Research
- Benefits for the Broader Community – Support of Basic Science Research
- Public Information and Education

City of Hope supports a variety of clinical and basic science research activities focused on finding cures and treatments for cancer and other life-threatening diseases and the development of diagnostics for which grant and other extramural funding is not available. The cost of these institutionally funded research efforts is considered a benefit to the broader community. In addition, the cost of providing public information and education is also considered a community benefit.

The Center and the Foundation accept all patients who are covered by governmental subsidized programs – primarily Medi-Cal and Medicare fee for service and who meet certain clinical criteria. These programs typically remit payments substantially less than charges and below the cost of providing the services. The Center and the Foundation have estimated the costs of treating patients less payments received for these costs. The residual amount of cost in excess of payments has been included as a component of community benefit.

City of Hope

Notes to Consolidated Financial Statements (continued)

10. Community Benefit Expense (Unaudited) (continued)

The following is a summary of the estimated benefits for the broader community through internally funded research support and Support of Governmental Health Care Programs – Medi-Cal and Medicare expense, at cost, in terms of service to the indigent for the years ended September 30 (amounts in thousands):

	<u>2018</u>	<u>2017</u>
Benefits for the Broader Community – Support for research (unaudited)		
Estimated institutionally supported research costs, net of grants received of \$152,821 and \$135,104 in 2018 and 2017, respectively		
Center	\$ 108,550	\$ 73,564
Institute	172,247	165,235
TGen	<u>26,460</u>	<u>23,600</u>
Total estimated benefits for the broader community, at cost	<u>307,257</u>	262,399
Support of Governmental Health Care Programs (unaudited)		
Estimated unreimbursed cost of the Medi-Cal Program, less net impact of California hospital fee program of \$109,145 and \$13,717 in 2018 and 2018, respectively	9,508	60,415
Estimated unreimbursed cost of the Medicare Program	<u>146,586</u>	<u>139,999</u>
	<u>156,094</u>	200,414
Total estimated benefits for the broader community and unreimbursed costs to governmental health care programs	<u>\$ 463,351</u>	<u>\$ 462,813</u>

11. Donor-Restricted Endowments

ASC 958 provides guidance on the net asset classification of donor-restricted endowment funds for a not-for-profit organization that is subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA). ASC 958 also contains disclosure provisions, which are included below.

Endowment: City of Hope’s endowment includes certain permanently and temporarily restricted, as well as unrestricted net assets that contain donor-restricted funds, as well as board-designated funds.

City of Hope

Notes to Consolidated Financial Statements (continued)

11. Donor-Restricted Endowments (continued)

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 requires to be retained as a fund of perpetual duration. Deficiencies of this nature are reported in unrestricted net assets unless the income from such endowment funds is restricted as to use, in which case such amounts are reflected in temporarily restricted net assets. As of September 30, 2018 and 2017, there were no material deficiencies of this nature.

Return Objectives and Risk Parameters: City of Hope's financial objective is to achieve a long-term rate of return that will enhance and preserve the real (inflation-adjusted) purchasing power of the corpus without subjecting the investment portfolio to large investment losses. Assets are invested in a manner that is intended to produce results that exceed the respective benchmark, while assuming a moderate level of investment risk. Actual returns in any given year may vary from this amount.

Strategies Employed for Achieving Objectives: To satisfy its long-term rate-of-return objectives, City of Hope 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). City of Hope targets a diversified asset allocation to achieve its long-term return objectives within prudent risk constraints.

Interpretation of Relevant Law: City of Hope has interpreted the Uniform Management of Institutional Funds Act (UMIFA) as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, City of Hope 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 the donor's restriction is met, at which time it is classified as unrestricted.

City of Hope

Notes to Consolidated Financial Statements (continued)

11. Donor-Restricted Endowments (continued)

In accordance with UPMIFA, City of Hope considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

- (1) The duration and preservation of the fund
- (2) The purposes of the donor-restricted endowment fund
- (3) General economic conditions
- (4) The possible effects of inflation and deflation
- (5) The expected total return from income and appreciation of investments
- (6) Other resources of City of Hope
- (7) The investment policies of City of Hope

The endowment net asset composition by type of fund as of September 30 consists of the following (amounts in thousands):

	2018			Total
	Unrestricted	Temporarily Restricted	Permanently Restricted	
Donor-restricted endowment funds	\$ (407)	\$ –	\$ 173,268	\$ 172,861
Temporarily restricted donor funds	–	78,619	–	78,619
Board-designated funds	884,534	–	–	884,534
Total funds	\$ 884,127	\$ 78,619	\$ 173,268	\$ 1,136,014

	2017			Total
	Unrestricted	Temporarily Restricted	Permanently Restricted	
Donor-restricted endowment funds	\$ (596)	\$ –	\$ 168,038	\$ 167,442
Temporarily restricted donor funds	–	65,724	–	65,724
Board-designated funds	816,234	–	–	816,234
Total funds	\$ 815,638	\$ 65,724	\$ 168,038	\$ 1,049,400

City of Hope

Notes to Consolidated Financial Statements (continued)

11. Donor-Restricted Endowments (continued)

The changes in endowment net assets for the years ended September 30 are as follows (amounts in thousands):

	2018			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, October 1, 2017	\$ 815,638	\$ 65,724	\$ 168,038	\$ 1,049,400
Contributions and additions	–	–	4,710	4,710
Investment returns:				
Investment income	12,923	3,666	20	16,609
Net appreciation – realized and unrealized	56,616	14,924	507	72,047
Appropriation of endowment assets for expenditure or transfers	(1,050)	(5,695)	(7)	(6,752)
Endowment net assets, September 30, 2018	<u>\$ 884,127</u>	<u>\$ 78,619</u>	<u>\$ 173,268</u>	<u>\$ 1,136,014</u>
	2017			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, October 1, 2016	\$ 715,191	\$ 40,624	\$ 161,344	\$ 917,159
Contributions and additions	75	5,327	6,520	11,922
Investment returns:				
Investment income	10,918	3,629	11	14,558
Net appreciation – realized and unrealized	90,363	22,693	163	113,219
Appropriation of endowment assets for expenditure or transfers	(909)	(6,549)	–	(7,458)
Endowment net assets, September 30, 2017	<u>\$ 815,638</u>	<u>\$ 65,724</u>	<u>\$ 168,038</u>	<u>\$ 1,049,400</u>

City of Hope

Notes to Consolidated Financial Statements (continued)

12. Restricted Net Assets

Temporarily restricted net assets are available for the following purposes as of September 30 (amounts in thousands):

	2018	2017
Time restricted under annuity and split-interest obligations and other	\$ 70,041	\$ 114,017
Patient care	15,620	12,668
Education	12,618	11,416
Research	296,858	225,767
Medical equipment and buildings	11,427	6,933
Total temporarily restricted net assets	\$ 406,564	\$ 370,801

Net assets were released from donor restrictions by satisfying the restricted purposes in the years ended September 30 (amounts in thousands):

	2018	2017
Time restricted under annuity and split-interest obligations and other	\$ 3,791	\$ 1,181
Patient care	513	172
Education	2,012	887
Research	54,244	40,945
Medical equipment and buildings	986	1,381
Total temporarily restricted net assets released from restrictions	\$ 61,546	\$ 44,566

Permanently restricted net assets are restricted investments to be held in perpetuity, the income from which is expendable to support the following purposes as of September 30 (amounts in thousands):

	2018	2017
Time restricted under annuity and split-interest obligations and other	\$ 21,486	\$ 9,233
Patient care	14,742	14,572
Education	18,342	18,472
Research	133,613	130,349
Medical equipment and buildings	3,510	3,510
Total permanently restricted net assets	\$ 191,693	\$ 176,136

City of Hope

Notes to Consolidated Financial Statements (continued)

13. Expenses

City of Hope provides critical patient care services and research to the community, along with public information and education. Expenses related to providing these services, and administrative and fundraising support, for the years ended September 30 are as follows (amounts in thousands):

	<u>2018</u>	<u>2017</u>
Salaries, wages, and employee benefits	\$ 740,439	\$ 613,639
Purchased services	290,157	274,013
Professional fees	161,582	145,263
Supplies and pharmaceuticals	424,740	376,564
Equipment rental and maintenance	22,719	22,606
Interest	36,253	27,631
Change in fair value of swap agreement	(3,718)	(6,686)
Depreciation and amortization	126,298	118,861
Occupancy	30,846	24,569
Royalty sharing	155,376	123,015
Hospital provider fee	40,836	7,604
Provision for bad debt	8,481	7,769
Loss on impairment of intangible assets	–	3,910
Other	29,143	33,517
Total expenses	<u>\$ 2,063,152</u>	<u>\$ 1,772,275</u>

14. Subsequent Events

On October 23, 2018, the Foundation entered into a 15-year lease agreement with a developer for a medical office building. The lease provides for the design and construction of a 60,000 square foot office building which is subject to build to suit accounting under ASC 840, *Leases*. The Foundation expects to begin operating a multi-disciplinary community cancer center at this location in 2020. The aggregate lease payments the Foundation will be obligated to make under the lease agreement are approximately \$16,470,000.

City of Hope has evaluated subsequent events occurring between the end of the most recent fiscal year and December 19, 2018, the date the financial statements were issued.

Supplementary Information

City of Hope

Consolidating Statements of Financial Position (In Thousands)

September 30, 2018 and 2017

	Obligated Group	Affiliated Group	Eliminating Entries	Consolidated 2018	Consolidated 2017
Assets					
Current assets:					
Cash and cash equivalents	\$ 341,678	\$ 35,893	\$ —	\$ 377,571	\$ 212,067
Investments	1,526,106	—	—	1,526,106	1,191,963
Self-insurance trust funds	3,765	—	—	3,765	3,352
Patient accounts receivable, net	238,384	—	—	238,384	245,192
Due from affiliates	5,119	31,374	(36,493)	—	—
Grants and other receivables	90,091	5,890	—	95,981	66,070
Due from third-party payors	342	—	—	342	9,817
Donor-restricted unconditional promises to give, net	13,989	4,587	—	18,576	49,399
Prepaid and other	35,174	3,931	—	39,105	36,654
Total current assets	2,254,648	81,675	(36,493)	2,299,830	1,814,514
Property and equipment, net	869,292	60,944	—	930,236	861,850
Other assets:					
Investments held for long-term purposes	302,822	—	—	302,822	313,812
Board-designated assets	884,127	—	—	884,127	815,638
Donor-restricted assets:					
Investments	495,839	22,412	—	518,251	442,913
Unconditional promises to give, net	56,632	4,109	—	60,741	54,036
Contributions receivable from annuity and split-interest agreements, net	13,182	—	—	13,182	13,623
Other	5,434	4,018	—	9,452	3,535
Intangible assets	608	5,459	—	6,067	6,086
Goodwill and other technology	—	63,667	—	63,667	4,600
Other long-term assets	126,201	2,888	(81,661)	47,428	53,211
Total other assets	1,884,845	102,553	(81,661)	1,905,737	1,707,454
Total assets	\$ 5,008,785	\$ 245,172	\$ (118,154)	\$ 5,135,803	\$ 4,383,818

City of Hope

Consolidating Statements of Financial Position (continued)
(In Thousands)

September 30, 2018 and 2017

	Obligated Group	Affiliated Group	Eliminating Entries	Consolidated 2018	Consolidated 2017
Liabilities and net assets					
Current liabilities:					
Accounts payable and accrued liabilities	\$ 139,391	\$ 10,838	\$ –	\$ 150,229	\$ 157,051
Accrued salaries, wages and employee benefits	84,187	3,286	–	87,473	68,783
Long-term debt, current portion	9,593	3,458	–	13,051	11,650
Deferred revenue	18,072	10,332	–	28,404	27,284
Due to third-party payors	–	–	–	–	–
Due to affiliates	29,377	7,116	(36,493)	–	–
Other	324	–	–	324	834
Total current liabilities	280,944	35,030	(36,493)	279,481	265,602
Long-term debt, net of current portion	959,862	43,948	–	1,003,810	683,411
Annuity and split-interest agreement obligations	20,464	–	–	20,464	18,580
Deferred rent	10,121	25	–	10,146	14,028
Interest rate swap	6,549	–	–	6,549	10,266
Other	57,934	2,181	–	60,115	56,501
Total liabilities	1,335,874	81,184	(36,493)	1,380,565	1,048,388
Net assets:					
Unrestricted:					
Controlling interests	3,108,300	95,242	(81,661)	3,121,881	2,788,493
Non-controlling interests in subsidiaries	–	35,100	–	35,100	–
Temporarily restricted	373,056	33,508	–	406,564	370,801
Permanently restricted	191,555	138	–	191,693	176,136
Total net assets	3,672,911	163,988	(81,661)	3,755,238	3,335,430
Total liabilities and net assets	\$ 5,008,785	\$ 245,172	\$ (118,154)	\$ 5,135,803	\$ 4,383,818

City of Hope
Consolidating Statements of Activities
(In Thousands)

Years Ended September 30, 2018 and 2017

	Obligated Group	Affiliated Group	Eliminating Entries	Consolidated 2018	Consolidated 2017
Revenues:					
Contributions (including \$31,983 and \$25,173 of contributions from special events in 2018 and 2017, respectively)	\$ 142,874	\$ 43,413	\$ (20,126)	\$ 166,161	\$ 147,546
Special event participation revenue	250	4,096	-	4,346	5,173
Less: cost of direct benefits to donors	(295)	(6,997)	-	(7,292)	(8,357)
Contributions and net revenues from special events	142,829	40,512	(20,126)	163,215	144,362
Net patient service revenues	1,375,498	-	-	1,375,498	1,186,167
Research grants and clinical trials	126,698	26,123	-	152,821	135,104
Investment income	184,221	216	-	184,437	141,292
Net unrealized gain (loss) on investments	27,170	(28)	-	27,142	180,393
Royalty and licensing revenues	498,870	1,500	-	500,370	398,096
Other	34,892	21,046	(11,372)	44,566	23,523
Total revenues	2,390,178	89,369	(31,498)	2,448,049	2,208,937
Expenses:					
Program services:					
Patient care	1,034,706	4,496	(4,381)	1,034,821	916,607
Research	495,556	42,524	-	538,080	448,796
Public information and education	24,891	-	-	24,891	17,429
Total program services	1,555,153	47,020	(4,381)	1,597,792	1,382,832
Supporting services:					
Administrative and general	418,654	26,736	(6,801)	438,589	359,423
Fundraising	21,126	5,645	-	26,771	30,020
Total supporting services	439,780	32,381	(6,801)	465,360	389,443
Total expenses	1,994,933	79,401	(11,182)	2,063,152	1,772,275
Excess of revenues and other increases over expenses	395,245	9,968	(20,316)	384,897	436,662
Distributions (to) from affiliates	(11,759)	(8,367)	20,126	-	-
Contributed capital - controlling interests	-	35,052	(35,052)	-	-
Contributed capital - non-controlling interests	-	34,911	-	34,911	-
Inherent contribution from Affiliation	-	-	-	-	46,419
Changes in net assets	383,486	71,564	(35,242)	419,808	483,081
Net assets, beginning of year	3,289,425	92,424	(46,419)	3,335,430	2,852,349
Net assets, end of year	\$ 3,672,911	\$ 163,988	\$ (81,661)	\$ 3,755,238	\$ 3,335,430

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