



CHOC FOUNDATION

Financial Statements

June 30, 2019 and 2018

(With Independent Auditors' Report Thereon)

CHOC FOUNDATION

Table of Contents

	Page(s)
Independent Auditors' Report	1
Financial Statements:	
Statements of Financial Position	3
Statements of Activities	4-5
Statements of Cash Flows	6
Notes to Financial Statements	7-18



KPMG LLP
Suite 700
20 Pacifica
Irvine, CA 92618-3391

Independent Auditors' Report

The Board of Directors
CHOC Foundation:

Report on the Financial Statements

We have audited the accompanying financial statements of CHOC Foundation, which comprise the statements of financial position as of June 30, 2019 and 2018, and the related statements of activities and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with 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 from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of CHOC Foundation as of June 30, 2019 and 2018, and the results of its operations and its cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.



Emphasis of Matters

As discussed in note 2(l) to the financial statements, beginning July 1, 2018, CHOC Foundation adopted new accounting guidance Accounting Standards Update (ASU) No. 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities*, ASU No. 2014-19, *Revenue from Contracts with Customers*, and ASU No. 2016-18, *Statement of Cash Flows*. Our opinion was not modified with respect to these matters.

KPMG LLP

Irvine, California
September 20, 2019

CHOC FOUNDATION

Statements of Financial Position

June 30, 2019 and 2018

Assets	2019	2018
Current assets:		
Cash and cash equivalents (note 3)	\$ 7,864,044	9,129,368
Pooled investments (note 4)	518,192	367,232
Assets whose use is limited, current (note 4)	5,403,810	7,878,086
Prepays and other current assets	485,699	665,218
Total current assets	14,271,745	18,039,904
Assets whose use is limited (note 4):		
Board-designated investments	17,273,629	15,661,581
Long-term pledges receivable, net of current portion	9,960,551	10,769,222
Charitable remainder trusts	392,787	417,361
Donor-designated funds	34,964,597	29,012,784
Total assets whose use is limited	62,591,564	55,860,948
Other assets:		
Property and equipment, net (note 7)	1,045,739	630,347
Total assets	\$ 77,909,048	74,531,199
Liabilities and Net Assets		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 1,650,870	1,247,803
Payable to related parties (note 11)	2,001,313	1,931,257
Total liabilities	3,652,183	3,179,060
Net assets:		
Without donor restrictions (note 9)		
Undesignated	6,261,491	7,613,108
Board-designated (note 8)	17,273,629	15,661,581
Total without donor restrictions	23,535,120	23,274,689
With donor restrictions	50,721,745	48,077,450
Total net assets	74,256,865	71,352,139
Total liabilities and net assets	\$ 77,909,048	74,531,199

See accompanying notes to financial statements.

CHOC FOUNDATION

Statement of Activities

Year ended June 30, 2019

	Without Donor Restrictions	With Donor Restrictions	Total
Public support and revenue:			
Public support	\$ 5,998,791	24,163,438	30,162,229
Special events	9,804,662	170,683	9,975,345
Less costs of direct benefits to donors	(3,069,028)	(20,000)	(3,089,028)
Net special events revenue	6,735,634	150,683	6,886,317
Net public support and special events	12,734,425	24,314,121	37,048,546
Net assets released from restrictions	23,750,456	(23,750,456)	—
Investment and other income (note 5)	1,040,739	2,133,970	3,174,709
Change in value of split-interest agreements	—	(24,574)	(24,574)
Total public support and revenue	37,525,620	2,673,061	40,198,681
Expenses:			
Contributions to affiliates	26,400,084	—	26,400,084
Management, general and institutional support	4,142,932	—	4,142,932
Fund-raising expenses	6,722,173	—	6,722,173
Provision for uncollectible pledges	—	28,766	28,766
Total expenses	37,265,189	28,766	37,293,955
Increase in net assets	260,431	2,644,295	2,904,726
Net assets at beginning of year	23,274,689	48,077,450	71,352,139
Net assets at end of year	\$ 23,535,120	50,721,745	74,256,865

See accompanying notes to financial statements.

CHOC FOUNDATION

Statement of Activities

Year ended June 30, 2018

	Without Donor Restrictions	With Donor Restrictions	Total
Public support and revenue:			
Public support	\$ 6,931,788	20,768,854	27,700,642
Special events	8,457,513	—	8,457,513
Less costs of direct benefits to donors	(3,015,757)	—	(3,015,757)
Net special events revenue	5,441,756	—	5,441,756
Net public support and special events	12,373,544	20,768,854	33,142,398
Net assets released from restrictions	14,077,663	(14,077,663)	—
Investment and other income (note 5)	885,092	1,579,508	2,464,600
Change in value of split-interest agreements	—	(99,667)	(99,667)
Total public support and revenue	27,336,299	8,171,032	35,507,331
Expenses:			
Contributions to affiliates	16,078,697	—	16,078,697
Management, general and institutional support	3,773,295	—	3,773,295
Fund-raising expenses	6,265,795	—	6,265,795
Total expenses	26,117,787	—	26,117,787
Increase in net assets	1,218,512	8,171,032	9,389,544
Net assets at beginning of year	22,056,177	39,906,418	61,962,595
Net assets at end of year	\$ 23,274,689	48,077,450	71,352,139

See accompanying notes to financial statements.

CHOC FOUNDATION

Statements of Cash Flows

Years ended June 30, 2019 and 2018

	2019	2018
Cash flows from operating activities:		
Increase in net assets	\$ 2,904,726	9,389,544
Adjustments to reconcile increase in net assets to net cash provided by (used in) operating activities:		
Realized and unrealized (gains) losses on investments, net	(1,650,373)	(1,626,650)
Change in value of split-interest agreements	24,574	99,667
Depreciation	95,364	74,118
Impairment	—	99,693
Decrease (increase) in operating assets:		
Pooled investments	(9,394,957)	6,219,382
Prepays and other current assets	179,519	(324,829)
Trusts and other receivables	650,777	(126,611)
Pledges receivable	3,282,947	(4,644,074)
Increase (decrease) in operating liabilities:		
Accounts payable and accrued liabilities	482,196	329,840
Payable to related parties	70,056	1,304,903
Net cash (used in) provided by operating activities	(3,355,171)	10,794,983
Cash flows from investing activity:		
Purchase of property and equipment	(589,884)	(528,386)
Net cash used in investing activity	(589,884)	(528,386)
Net (decrease) increase in cash and cash equivalents	(3,945,055)	10,266,597
Cash, cash equivalents, and restricted cash at beginning of year	22,183,539	11,916,942
Cash, cash equivalents, and restricted cash at end of year	\$ 18,238,484	22,183,539
Supplemental disclosures of cash flow information:		
Change in capital expenditures accrued but not yet paid	\$ 79,128	100,614

See accompanying notes to financial statements.

CHOC FOUNDATION

Notes to Financial Statements

June 30, 2019 and 2018

(1) Organization and Purpose

CHOC Foundation (the Organization) was formed to help support clinical and nonclinical medical education, research, and allied fields of pediatrics at Children's Hospital of Orange County (CHOC) and Children's Hospital at Mission (CCMH), and to support its other affiliates. Revenue is derived from fund-raising activities organized by the Organization.

Children's HealthCare of California (CHC) is the sole member of the Organization. Other affiliates of CHC include CHOC, CCMH, and CRC Real Estate Corporation (CRC).

(2) Summary of Significant Accounting Policies

(a) Basis of Presentation

The accompanying financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP).

(b) Cash Equivalents

The Organization considers certain money market funds and all highly liquid investments with original or remaining maturities of three months or less when acquired to be cash equivalents.

(c) Investments

Investments classified as trading securities consist of fixed-income securities, domestic equity funds, common and preferred stocks, and international common stocks held by CHC. All investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value based upon their own quoted market prices or quoted market prices for similar instruments at the reporting date in the statements of financial position.

Investment income and losses from the CHC investment pool are allocated between CHC and other members of the pool, including the Organization, based upon investment balances. The Organization recognizes changes in its interest in the CHC investment pool using a method that is similar to the equity method of accounting.

Pooled investments held at the Organization are recorded at the Organization's share of the carrying value of the CHC investment pool. Investment income or loss (including realized gains and losses on investments, unrealized gains and losses, interest, and dividends) is included in investment and other income in the accompanying statements of activities.

(d) Assets Whose Use is Limited

Assets whose use is limited include assets whose use has been limited by donors, and assets designated by the board of directors for endowment, over which the board of directors retains control and may at its discretion subsequently use for other purposes. A portion of these assets are maintained in the pooled investment portfolio.

(e) Net Assets with Donor Restrictions

Net assets with donor restrictions are those funds whose use by the Organization has been limited by donors to a specific time period or purpose or have been restricted by donors to be maintained by the

CHOC FOUNDATION

Notes to Financial Statements

June 30, 2019 and 2018

Organization in perpetuity. The assets are generally invested by the Organization as part of its overall investment portfolio.

(f) Contributions

Unconditional promises to give cash and other assets to the Organization are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value when all the conditions are met. The gifts are reported as net assets with donor restrictions if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, net assets with donor restrictions are reclassified as undesignated net assets and reported in the statements of activities as net assets released from restrictions.

(g) Property and Equipment

Property and equipment are stated at cost and are depreciated using the straight-line method over the following estimated useful lives:

Equipment	3 to 10 years
Leasehold improvements	Lesser of useful life or lease term

Gifts of long-lived assets such as land, buildings, or equipment are reported 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 the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service. Gifts of long-lived assets are recorded at fair value at the time the gift is made.

(h) Impairment of Long-Lived Assets

Long-lived assets, such as property and equipment, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If review indicates an impairment may have occurred, recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. In addition to consideration of impairment due to the events or changes in circumstances described above, management regularly evaluates the remaining lives of its long-lived assets. If estimates are revised, the carrying value of affected assets is depreciated or amortized over remaining lives. Impairment was recognized in the amounts of \$0 and \$99,693 at June 30, 2019 and 2018, respectively.

CHOC FOUNDATION

Notes to Financial Statements

June 30, 2019 and 2018

(i) Income Taxes

The Organization is exempt from taxation under Section 501(c)(3) of the Internal Revenue Code and Section 23701d of the California Revenue and Taxation Code and is generally not subject to federal or state income taxes. However, the Organization is subject to income taxes on any net income that is derived from a trade or business, regularly carried on, and not in furtherance of the purposes for which it was granted exemption. No income tax provision has been recorded as the net income, if any, from any unrelated trade or business, in the opinion of management, is not material to the financial statement taken as a whole.

GAAP requires the Organization's management to evaluate tax positions taken by the Organization and recognizes a tax liability if the Organization has taken an uncertain position that more likely than not would not be sustained upon examination by the Internal Revenue Service. Management has analyzed tax positions taken by the Organization and has concluded that as of June 30, 2019, there are no uncertain positions taken or expected to be taken that would require recognition of a liability or disclosure in the financial statements. The Organization is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress. The Organization's management believes it is no longer subject to income tax examinations for years prior to 2014.

(j) Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Significant items subject to such estimates and assumptions include the carrying amount of property and equipment, trusts, bequests, and pledges receivable. Actual results could differ from those estimates.

(k) Reclassifications

Certain amounts in the prior year's presentations have been reclassified to conform to the current presentation. These reclassifications are a result of the adoption of new accounting pronouncements applicable in the current year and had no effect on previously reported change in net assets.

(l) Recently Issued Accounting Standards

On July 1, 2018, the Organization adopted Accounting Standards Update (ASU) No. 2016-14, *Not for Profit Entities* (Topic 958), which changes the way a not for profit entity (NFP) classifies and presents net assets on the face of the financial statements and presents information in the financial statements and notes about the NFP's liquidity, financial performance and cash flows. The amendment changes the way an NFP reports classes of net assets, from the currently required three classes to two, by eliminating the distinction between resources with permanent restrictions and those with temporary restrictions. The amendment also requires NFP to provide enhanced disclosure about the nature, amounts and effects of the various types of donor-imposed restrictions, the NFP's management of its liquidity to meet short term demands for cash, and the types of resources used and how they are allocated to carrying out the NFP's activities. The implementation of ASU No. 2016-14 did not have a material effect on the financial statements other than the additional disclosures required by the standard.

CHOC FOUNDATION

Notes to Financial Statements

June 30, 2019 and 2018

On July 1, 2018, the Organization adopted ASU No. 2016-18, *Statement of Cash Flows – Restricted Cash*, which requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and restricted cash or restricted cash equivalents. The Organization applied a retrospective transition method to each period presented.

On July 1, 2018, the Organization adopted ASU No. 2018-08, *Clarifying the Scope of the Accounting Guidance for Contributions Received and Contributions Made*, which requires that an entity evaluate whether transactions should be accounted for as contributions or as exchange transactions and determining whether a contribution is conditional. The Organization adopted ASU No. 2018-08 using a modified prospective application to agreements not completed as of July 1, 2018 and to agreements entered into after July 1, 2018. The implementation of ASU No. 2018-08 did not have a material effect on the Organization's financial positions, results of operations, or cash flows. There was no cumulative effect of a change in accounting principle recorded related to the adoption of ASU No. 2018-08 on July 1, 2018.

In February 2016, the FASB issued ASU No. 2016-02, *Leases*, which expands the qualitative and quantitative disclosure requirements around leasing transactions while also requiring lessees to recognize most leases on balance sheet. The Organization has completed an evaluation of the requirements of the new standard to ensure that there are processes, systems and internal controls in place to collect the necessary information to implement the standard, which became effective for the Organization on July 1, 2019. The primary effect of adopting the new standard will be the recording of right-of-use assets and obligation for the Organization's leases currently classified as operating leases totaling approximately \$7,100,000.

(3) Cash, Cash Equivalents, and Restricted Cash

The table below provides a reconciliation of cash, cash equivalents, and restricted cash reported on the balance sheet that sum to the total of those same amounts shown in the statement of cash flows.

	<u>2019</u>	<u>2018</u>
Cash and cash equivalents	\$ 7,864,044	9,129,368
Restricted cash included in board-designated investments	7,003	8,075,540
Restricted cash included in donor-designated funds	<u>10,367,437</u>	<u>4,978,631</u>
	<u>\$ 18,238,484</u>	<u>22,183,539</u>

(4) Investments and Assets Whose Use is Limited

Certain of the Organization's investments are maintained in an investment portfolio managed by CHC as part of a commingled investment portfolio (pooled investments). The funds are held by a bank custodian and are managed by professional investment managers. The CHC investment pool consists of fixed income securities, domestic equity funds, common and preferred stocks and international common stocks that have been classified as trading securities. All investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value based upon their own quoted market prices or quoted market prices for similar instruments at the reporting date in the statements of financial position.

CHOC FOUNDATION

Notes to Financial Statements

June 30, 2019 and 2018

Pooled investments are recorded at the Organization's share of the carrying value of the CHC investment pool. The CHC investment pool at June 30, 2019 and 2018 was invested as follows (in percentages):

	2019	2018
Cash and cash equivalents	13 %	27 %
Corporate debt securities	25	15
U.S. Treasury and agency debt securities	12	6
Foreign government debt securities	—	1
Domestic equity funds	34	32
Common and preferred stocks	—	1
International common stocks	16	18
	100 %	100 %

Investments and assets whose use is limited are held by and consist of designated amounts at June 30, 2019 and 2018 as follows:

	2019		
	CHC investment pool	Held by organization	Total
Pooled investments	\$ 518,192	—	518,192
Assets whose use is limited:			
Board-designated investments	16,521,847	751,782	17,273,629
Pledges receivable – current	—	5,403,810	5,403,810
Pledges receivable – long term	—	9,960,551	9,960,551
Charitable remainder trusts	—	392,787	392,787
Donor-restricted funds	24,663,875	10,300,722	34,964,597
	\$ 41,703,914	26,809,652	68,513,566

	2018		
	CHC investment pool	Held by organization	Total
Pooled investments	\$ 367,232	—	367,232
Assets whose use is limited:			
Board-designated investments	15,661,581	—	15,661,581
Pledges receivable – current	—	7,878,086	7,878,086
Pledges receivable – long term	—	10,769,222	10,769,222
Charitable remainder trusts	—	417,361	417,361
Donor-restricted funds	22,698,308	6,314,476	29,012,784
	\$ 38,727,121	25,379,145	64,106,266

CHOC FOUNDATION

Notes to Financial Statements

June 30, 2019 and 2018

Donor-restricted funds held by the Organization consist of \$9,615,656 and \$4,978,633 in cash and cash equivalents and \$685,066 and \$1,335,843 in receivables at June 30, 2019 and 2018, respectively.

A summary of pledges receivable at June 30, 2019 and 2018 is as follows:

	2019	2018
Pledges receivable before unamortized discount and allowance for uncollectibles	\$ 18,174,954	20,560,155
Less allowance for uncollectibles	(54,960)	(54,960)
Subtotal	18,119,994	20,505,195
Less unamortized discount	(2,755,633)	(1,784,461)
Net pledges receivable	\$ 15,364,361	18,720,734
Amounts due in:		
Less than one year	\$ 5,403,810	7,878,086
One year to five years	10,817,184	12,627,109
Six years or more	1,899,000	—
Total	\$ 18,119,994	20,505,195

Pledges receivable are discounted at the date of receipt. Discount rates applied to pledges receivable ranged from 4.625% to 9.250% for the fiscal years ended June 30, 2019 and 2018.

(5) Investment and Other Income

Investment and other income for cash and cash equivalents, pooled investments, and assets whose use is limited, included in undesignated interest and other income in the statements of activities, comprise the following for the years ended June 30, 2019 and 2018:

	2019	2018
Interest and dividend income	\$ 1,524,336	837,950
Net realized (loss) gain on investments	(24,365)	6,236,501
Net unrealized gain (loss) on investments	1,674,738	(4,609,851)
Total investment income	\$ 3,174,709	2,464,600

CHOC FOUNDATION

Notes to Financial Statements

June 30, 2019 and 2018

(6) Liquidity and Capital Resources

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

	<u>2019</u>	<u>2018</u>
Cash and cash equivalents	\$ 7,864,044	9,129,368
Pooled investments	518,192	367,232
Assets whose use is limited, board designated funds	<u>17,273,629</u>	<u>15,661,581</u>
	<u>\$ 25,655,865</u>	<u>25,158,181</u>

The Organization has certain board designated assets whose use is limited which are available for general expenditure within one year in the normal course of operations. Accordingly, these assets have been included in the qualitative information above. The Organization has other assets whose use is limited for donor-restricted purposes. These assets whose use is limited and are not available for general expenditure within the next year and are not reflected in the amounts above.

As part of the Organization's liquidity management plan, cash in excess of daily requirements are invested in short-term investments and money market funds.

(7) Property and Equipment

A summary of property and equipment at June 30, 2019 and 2018 is as follows:

	<u>2019</u>	<u>2018</u>
Equipment	\$ 501,241	490,716
Leasehold improvements	1,235,801	115,941
Construction in progress	<u>—</u>	<u>624,593</u>
	1,737,042	1,231,250
Less accumulated depreciation and amortization	<u>(691,303)</u>	<u>(600,903)</u>
Property and equipment, net	<u>\$ 1,045,739</u>	<u>630,347</u>

For the fiscal years ended June 30, 2019 and 2018, the Organization recognized depreciation expense of \$95,364 and \$74,118, respectively.

(8) Board Designated Net Assets

For the fiscal years ended June 30, 2019 and 2018, the Organization had board designated net assets available for medical program costs of \$4,185,319 and \$3,433,537, respectively. The Organization also had available \$13,088,310 and \$12,228,044, respectively, for general activities.

CHOC FOUNDATION

Notes to Financial Statements

June 30, 2019 and 2018

(9) Net Assets with Donor Restrictions

Net assets with donor restrictions are available for the following purposes at June 30, 2019 and 2018:

	<u>2019</u>	<u>2018</u>
Building and equipment	\$ 1,744,432	9,278,685
Healthcare services	12,482,180	9,495,005
Pledge receivable, restricted as to time	12,441,491	7,118,463
Trusts receivable, restricted as to time	<u>392,787</u>	<u>417,361</u>
	<u>\$ 27,060,890</u>	<u>26,309,514</u>

Net assets with donor restrictions held in perpetuity at June 30, 2019 and 2018 are restricted for the following:

	<u>2019</u>	<u>2018</u>
Investments to be held in perpetuity, the income from which is expendable to support healthcare services	\$ 22,218,754	19,094,342
Endowments requiring income to be added to original gift	263,663	423,433
Permanently restricted pledges receivable	<u>1,178,438</u>	<u>2,250,161</u>
	<u>\$ 23,660,855</u>	<u>21,767,936</u>

(10) Endowment

Accounting Standards Codification (ASC) Topic 958, *Not-for-Profit Entities*, provides guidance relating to the treatment of net assets with donor restrictions to be consistent with the Uniform Prudent Management of Institution Funds Act of 2006 (UPMIFA) legislation. ASC 958 also provides guidance relating to disclosure about an organization's endowment funds (both donor-restricted endowment funds and board-designated endowment funds). The Organization's endowment consists of approximately 41 individual funds established for a variety of purposes. Its endowment includes both donor-restricted endowment funds and funds designated by the CHOC Foundation board of directors to function as endowments. Net assets associated with endowment funds, including funds designated by the Foundation board of directors to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

The Foundation board of directors has interpreted UPMIFA 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, the Organization classifies as net assets with donor restrictions (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 purpose restricted is also classified as net assets with donor restrictions until those amounts are appropriated for expenditure by the Organization in a manner consistent with the standard of prudence prescribed by UPMIFA. In

CHOC FOUNDATION

Notes to Financial Statements

June 30, 2019 and 2018

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

- Duration and preservation of the fund
- Purposes of the Organization and the donor-restricted endowment fund
- General economic conditions
- Possible effect of inflation and deflation
- Expected total return from income and the appreciation of investments
- Other resources of the Organization
- Investment policies of the Organization

Donor restricted endowment funds and the unexpended portion of the purpose-restricted endowment earnings are components of net assets with donor restrictions. Donor-restricted endowment funds include gifts totaling \$263,663 and \$423,433 as of June 30, 2019 and 2018, respectively, which require income to be added to the original gift until designated by the donor. Undesignated endowment net assets are board-designated. Changes in endowment net assets for the years ended June 30, 2019 and 2018:

	<u>Undesignated endowments</u>	<u>Donor restricted endowments</u>	<u>Total</u>
Balance as of June 30, 2017	\$ 14,169,017	25,368,655	39,537,672
Contributions	842,746	508,325	1,351,071
Investment income	788,028	1,567,654	2,355,682
Appropriated for expenditure	<u>(138,210)</u>	<u>(582,352)</u>	<u>(720,562)</u>
Balance as of June 30, 2018	15,661,581	26,862,282	42,523,863
Contributions	775,425	1,880,850	2,656,275
Investment income	997,034	2,010,167	3,007,201
Appropriated for expenditure	<u>(160,411)</u>	<u>(894,934)</u>	<u>(1,055,345)</u>
Balance as of June 30, 2019	<u>\$ 17,273,629</u>	<u>29,858,365</u>	<u>47,131,994</u>

(a) 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 that the Organization retain as a fund of perpetual duration. In accordance with GAAP, deficiencies of this nature, net of related donor restricted income, are reported in net assets with donor restrictions. No deficiency existed for fiscal year 2019 or 2018.

(b) Return Objectives and Risk Parameters

The Organization has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the Organization must hold in perpetuity or for a donor-specified period(s)

CHOC FOUNDATION

Notes to Financial Statements

June 30, 2019 and 2018

as well as board-designated endowment funds. Under this policy, as approved by the board of directors, the endowment assets are invested in a manner that is intended to produce results that exceed the price and yield results of the Standard and Poor's 500 index while assuming a moderate level of investment risk. The Organization expects its endowment funds, over time, to provide an average rate of return of approximately 5% to 7% annually. Actual returns in any given year may vary from this amount.

(c) *Strategies Employed for Achieving Objectives*

To satisfy its long-term rate-of-return objectives, the Organization relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yields (interest and dividends). The Organization targets a diversified asset allocation that places a greater emphasis on equity-based investments to achieve its long-term return objectives within prudent risk constraints.

(d) *Spending Policy and How the Investment Objectives Relate to Spending Policy*

The Organization has a policy of appropriating for distribution each year from 3% to 5% of its endowment fund's average fair value over the prior nine quarters through the fiscal year-end preceding the fiscal year in which the distribution is planned unless specified differently by the donor in the endowment gift agreement. In establishing this policy, the Organization considered the long-term expected return on its endowments. Accordingly, over the long term, the Organization expects the current spending policy to allow its endowment to grow at an average of 1% to 3% annually. This is consistent with the Organization's objective to maintain the purchasing power of the endowment assets held in perpetuity or for a specified term as well as to provide additional real growth through new gifts and investment return.

(11) Related-Party Transactions

(a) *Donations*

The Organization holds trusts and pledges receivable for which the donor has specified its affiliates as the beneficiary. As of June 30, 2019 and 2018, trusts and pledges receivable held for the benefit of CHOC and CCMH totaled \$13,150,685 and \$16,551,810, respectively, as a component of assets whose use is limited in the statements of financial position.

(b) *Contributions to Affiliates*

The Organization receives contributions on behalf of CHOC and CCMH and transfers the funds to its affiliates as specified by the donors. During the years ended June 30, 2019 and 2018, the Organization transferred contributions to affiliates of \$26,400,084 and \$16,078,697, respectively. At June 30, 2019 and 2018, the Organization had a payable to CHOC of \$1,899,426 and \$1,830,867, respectively and payable to CCMH of \$48,554 and \$58,724, respectively.

(c) *Management Agreement*

The Organization has a written agreement with CHOC under which CHOC provides certain managerial and accounting services to the Organization. The Organization incurred fees of \$600,000 and \$459,996 with CHOC during fiscal years 2019 and 2018, respectively, under such agreement. At June 30, 2019 and 2018, the Organization had a payable to CHOC of \$50,000 and \$38,333 respectively. Also, the

CHOC FOUNDATION

Notes to Financial Statements

June 30, 2019 and 2018

Organization has a similar agreement with CHC for certain other managerial services. The Organization incurred fees of \$39,996 under this agreement with CHC during fiscal years 2019 and 2018. At June 30, 2019 and 2018, the Organization had a payable to CHC of \$3,333. All of these fees are included in management, general and institutional support; and fund-raising expenses in the accompanying statements of activities.

(d) Rental Expenses

The Organization rents office facilities from CRC, the expense for which totaled \$476,966 and \$284,894 for the years ended 2019 and 2018, respectively, and is included in management, general, and institutional support and fundraising expenses in the accompanying statements of activities.

The Organization entered into a 10 year lease for new office facilities with CRC that commenced February, 2019. The total rent payable for the 10 year period will be \$5,715,839, an average of \$571,584 annually.

(12) Functional Expenses

The Organization supports CHOC, CCMH, and its affiliates in providing healthcare services to residents within its geographic location. Operating expenses at June 30, 2019 and 2018 are presented by their functional classifications as follows for the years ended June 30:

	2019			
	Program activities	Supporting activities		Total operating expenses
	Affiliate support	Mgmt, General, & Institutional Support	Fundraising	
		Support		
Salaries	\$ —	2,825,627	4,219,200	7,044,827
Purchased services	—	693,190	738,654	1,431,844
Supplies	—	114,363	612,906	727,269
Rent	—	318,973	169,983	488,956
Depreciation	—	62,940	32,424	95,364
Other	—	127,839	977,772	1,105,611
Contributions to affiliates	26,400,084	—	—	26,400,084
	\$ 26,400,084	4,142,932	6,750,939	37,293,955

CHOC FOUNDATION

Notes to Financial Statements

June 30, 2019 and 2018

	2018			
	Program activities	Supporting activities		Total operating expenses
	Affiliate support	Mgmt, General, & Institutional Support	Fundraising	
Salaries	\$ —	2,399,861	3,911,684	6,311,545
Purchased services	—	626,238	887,015	1,513,253
Supplies	—	201,880	535,306	737,186
Rent	—	194,539	104,430	298,969
Depreciation	—	114,715	59,096	173,811
Other	—	236,062	768,264	1,004,326
Contributions to affiliates	16,078,697	—	—	16,078,697
	<u>\$ 16,078,697</u>	<u>3,773,295</u>	<u>6,265,795</u>	<u>26,117,787</u>

(13) Concentration of Credit Risk

Financial instruments that potentially subject the Organization to significant concentration of credit risk consist principally of cash and cash equivalents, pooled investments, assets whose use is limited, pledge receivables, and trust receivables held by the Organization. Although the majority of its cash and cash equivalents accounts exceed the federally insured deposit amount, management does not anticipate nonperformance by its financial institutions and it reviews the financial viability of these institutions on a periodic basis. The Organization attempts to limit its risk on investments and assets whose use is limited by having an active investment committee of the board of directors approve the investment policy, diversification of funds, investment manager selection, and asset allocation on a regular basis for compliance. The Organization attempts to limit its risk on pledge receivables and trust receivables by evaluating the donors' credentials and their ability to fulfill their promise.

(14) Subsequent Events

The Organization has evaluated subsequent events from the statement of financial position date through September 20, 2019, the date on which the financial statements were available to be issued.