# KENNEDY KRIEGER INSTITUTE, INC. AND AFFILIATES

**Consolidated Financial Statements**
**June 30, 2018 and 2017**

# Kennedy Krieger Institute, Inc. and Affiliates
## Index
## June 30, 2018 and 2017

### Report of Independent Auditors

To the Board of Directors of
Kennedy Krieger Institute, Inc. and Affiliates

We have audited the accompanying consolidated financial statements of Kennedy Krieger Institute, Inc. and Affiliates (the "Institute"), which comprise the consolidated balance sheets as of June 30, 2018 and 2017, and the related consolidated statements of operations, changes in net assets and cash flows for the years then ended.

#### *Management's Responsibility for the Consolidated Financial Statements*

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

#### *Auditor's Responsibility*

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

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

*PricewaterhouseCoopers LLP, 100 East Pratt Street, Suite 2600, Baltimore, MD 21202*
*T: (410) 783-7600, F: (410) 783-7680, www.pwc.com/us*

***Opinion***

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Kennedy Krieger Institute, Inc. and Affiliates at June 30, 2018 and 2017, and the results of their operations, changes in net assets and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

PricewaterhouseCoopers LLP

Baltimore, Maryland
September 27, 2018

# Kennedy Krieger Institute, Inc. and Affiliates
## Consolidated Balance Sheets
## As of June 30, 2018 and 2017
## (in thousands)

| ASSETS | 2018 | 2017 |
|---|---|---|
| Current assets: | | |
| Cash and cash equivalents | $ 15,407 | $ 16,955 |
| Patient receivables, less allowances of $5,529 and $4,715 | 22,313 | 17,811 |
| Grant and contract receivable | 5,048 | 8,582 |
| Tuition receivable | 6,094 | 4,025 |
| Pledges receivable | 9,038 | 7,410 |
| Investments limited as to use | 7,676 | 24,943 |
| Prepaid expenses and other | 2,183 | 1,564 |
| Total current assets | 67,759 | 81,290 |
| Non-current assets: | | |
| Property and equipment, net | 145,234 | 121,699 |
| Investments: | | |
| Board designated endowment | 55,915 | 52,227 |
| Investments limited as to use | 7,765 | 7,250 |
| Pledges receivable, less allowances of $2,208 and $2,561 | 3,763 | 8,859 |
| Total non-current assets | 212,677 | 190,035 |
| Total assets | $ 280,436 | $ 271,325 |
| LIABILITIES AND NET ASSETS | | |
| Current liabilities: | | |
| Accounts payable and accrued expenses | 34,107 | 30,240 |
| Deferred grant revenue | 2,210 | 1,907 |
| Current portion of tax-exempt bonds | 3,125 | 2,361 |
| Total current liabilities | 39,442 | 34,508 |
| Long-term liabilities: | | |
| Tax-exempt bonds, net | 80,403 | 83,473 |
| Accrued pension | 14,740 | 18,193 |
| Interest rate swap | 6,320 | 8,545 |
| Other long-term liabilities | 3,924 | 2,323 |
| Total long-term liabilities | 105,387 | 112,534 |
| Total liabilities | 144,829 | 147,042 |
| Net assets: | | |
| Unrestricted | 99,783 | 86,255 |
| Temporarily restricted | 34,866 | 37,070 |
| Permanently restricted | 958 | 958 |
| Total net assets | 135,607 | 124,283 |
| Total liabilities and net assets | $ 280,436 | $ 271,325 |

See accompanying notes to consolidated financial statements.

# Kennedy Krieger Institute, Inc. and Affiliates
## Consolidated Statements of Operations
## For the years ended June 30, 2018 and 2017
## (in thousands)

| | 2018 | 2017 |
|---|---|---|
| Operating revenues: | | |
| Patient service revenue, net of contractual allowances | $ 170,593 | $ 164,230 |
| Bad debt expense | (4,429) | (3,583) |
| Net patient service revenue | 166,164 | 160,647 |
| Tuition revenue | 48,944 | 46,870 |
| Grant and contract revenue | 33,949 | 36,518 |
| Net assets released for operating activities | 3,819 | 4,168 |
| Investment earnings used for operating activities | 2,022 | 2,000 |
| Unrestricted contributions from fundraising activities, net | 1,623 | 1,102 |
| Other operating revenues | 1,574 | 1,411 |
| Total operating revenues | 258,095 | 252,716 |
| Operating expenses: | | |
| Salaries, wages and benefits | 191,473 | 182,442 |
| Supplies, purchased services, and other | 49,356 | 51,664 |
| Depreciation and amortization | 9,214 | 9,508 |
| Rent | 2,800 | 2,369 |
| Interest | 1,882 | 1,828 |
| Total operating expenses | 254,725 | 247,811 |
| Operating revenues over operating expenses | 3,370 | 4,905 |
| Non-operating activity: | | |
| Investment income and realized gain/(loss), net | 344 | (534) |
| Unrealized change in investments, net | 2,796 | 6,053 |
| Realized and unrealized gain on interest rate swap | 1,271 | 2,650 |
| Restricted fundraising expenses | (1,185) | (988) |
| Loss on early extinguishment of debt | - | (168) |
| Net non-operating activities | 3,226 | 7,013 |
| Excess of revenue over expenses | $ 6,596 | $ 11,918 |

See accompanying notes to consolidated financial statements.

# Kennedy Krieger Institute, Inc. and Affiliates
## Consolidated Statements of Changes in Net Assets
## for the years ended June 30, 2018 and 2017
## (in thousands)

| | 2018 | 2017 |
|---|---|---|
| Unrestricted net assets: | | |
| Excess of revenue over expenses | $ 6,596 | $ 11,918 |
| Net assets released from restrictions used for property and equipment | 5,005 | 1,414 |
| Change in funded status of defined benefit plan, net | 1,927 | 2,423 |
| Increase in unrestricted net assets | 13,528 | 15,755 |
| Unrestricted net assets, beginning of year | 86,255 | 70,500 |
| Unrestricted net assets, end of year | $ 99,783 | $ 86,255 |
| Temporarily restricted net assets: | | |
| Contributions from fundraising activities | 6,620 | 4,987 |
| Net assets released from restrictions used for: | | |
| Operating activities | (3,819) | (4,168) |
| Purchases of property and equipment | (5,005) | (1,414) |
| (Decrease) in restricted net assets | (2,204) | (595) |
| Restricted net assets, beginning of year | 37,070 | 37,665 |
| Restricted net assets, end of year | $ 34,866 | $ 37,070 |
| Permanently restricted net assets: | | |
| Contributions from fundraising activities | - | - |
| Increase in permanently restricted net assets | - | - |
| Permanently restricted net assets, beginning of year | 958 | 958 |
| Permanently restricted net assets, end of year | $ 958 | $ 958 |
| Increase in total net assets | 11,324 | 15,160 |
| Total net assets, beginning of year | 124,283 | 109,123 |
| Total net assets, end of year | $ 135,607 | $ 124,283 |

See accompanying notes to consolidated financial statements.

# Kennedy Krieger Institute, Inc. and Affiliates
## Consolidated Statements of Cash Flows
## for the years ended June 30, 2018 and 2017
## (in thousands)

| | 2018 | 2017 |
|---|---|---|
| Cash flows from operating activities: | | |
| Change in net assets | $ 11,324 | $ 15,160 |
| Adjustments to reconcile change in net assets to net cash (used in) provided by operating activities: | | |
| Net realized and unrealized (gains) on investments, net | (3,490) | (6,146) |
| Depreciation and amortization | 9,214 | 9,508 |
| Bad debt expense | 4,428 | 3,583 |
| Change in pension liability, net | (3,453) | (4,323) |
| Change in valuation of interest rate swap | (2,225) | (3,825) |
| Restricted contributions | (6,881) | (3,873) |
| Loss on early extinguishment of debt | - | 167 |
| Changes in assets and liabilities: | | |
| Patient receivables | (8,930) | (2,139) |
| Other receivables | 4,933 | 4,391 |
| Prepaid expenses | (619) | (55) |
| Accounts payable and accrued expenses | 3,017 | 4,815 |
| Deferred grant revenue | 303 | (262) |
| Other liabilities | 311 | 13 |
| Net cash provided by operating activities | 7,932 | 17,014 |
| Cash flows from investing activities: | | |
| Purchase of property and equipment | (30,249) | (8,699) |
| Net sales of investments | (198) | (245) |
| Funding of construction funds | (1,612) | (27,916) |
| Draws on construction funds | 18,879 | 2,972 |
| Other changes in investments limited as to use | (515) | (705) |
| Net cash used in investing activities | (13,695) | (34,593) |
| Cash flows from financing activities: | | |
| Proceeds from issuance of tax-exempt bonds | - | 50,510 |
| Payments for refunding of tax-exempt bonds | - | (27,440) |
| Payments on tax-exempt bonds | (2,305) | (2,262) |
| Proceeds from line of credit | 8,800 | 8,000 |
| Payments on line of credit | (8,800) | (10,250) |
| Payments on capital lease obligation | (361) | (294) |
| Proceeds from restricted contributions | 6,881 | 3,873 |
| Net cash provided by financing activities | 4,215 | 22,137 |
| Net increase (decrease) in cash and cash equivalents | (1,548) | 4,558 |
| Cash and cash equivalents, beginning of year | 16,955 | 12,397 |
| Cash and cash equivalents, end of year | $ 15,407 | $ 16,955 |
| Supplemental disclosure of cash flow information: | | |
| Cash paid during the year for interest | $ 1,882 | $ 1,828 |
| Purchases of property and equipment in accounts payable | $ 2,992 | $ 14 |

See accompanying notes to consolidated financial statements.

### 1. DESCRIPTION OF ORGANIZATION

Kennedy Krieger Institute, Inc. and Affiliates (the "Institute") is an internationally recognized organization dedicated to improving the lives of children, adolescents and young adults through comprehensive patient care, education and research. The Institute's primary operating activities include healthcare services, research, training, special education and fundraising.

The operations of the Institute are carried out through a number of legal corporate entities. The consolidated financial statements of the Institute reflect the accounts of the following separate legal corporate entities:

Kennedy Krieger Institute, Inc.
Kennedy Krieger Children's Hospital, Inc.
Hugo W. Moser Research Institute at Kennedy Krieger, Inc.
Kennedy Krieger Education and Community Services, Inc.
Kennedy Krieger Associates, Inc.
PACT: Helping Children with Special Needs, Inc.
Kennedy Krieger Foundation, Inc.
Madison Street Properties, Inc.

Healthcare services are provided through Kennedy Krieger Children's Hospital, Inc. and include a forty-five bed inpatient unit admitting more than 350 patients yearly, over fifty specialty outpatient clinics generating in excess of 200,000 annual visits and the training of over 400 healthcare professionals each year. Net patient service revenue generated through Healthcare activities represents approximately 64.4% and 63.6% of the Institute's operating revenue in fiscal years 2018 and 2017, respectively.

Studies conducted through Research activities within the Hugo W. Moser Research Institute at Kennedy Krieger, Inc. are provided through over 125 government and private awards. Research grant and contract revenue represents approximately 13.2% and14.5% of the Institute's operating revenue in fiscal years 2018 and 2017, respectively. Approximately 78.1% and 78.6% of this revenue in fiscal years 2018 and 2017, respectively, comes from departments and agencies of the United States government. Major government sponsors included the Department of Health and Human Services, the Department of Defense and the Department of Justice.

Special education services provided through Kennedy Krieger Education & Community Services, Inc. are conducted through non-public special education schools for students from kindergarten to grade eight, high school, specialized autism programs and partnership programs within public schools. Tuition and related contractual revenue generated through special education services represents approximately 19.0% and 18.5% of the Institute's operating revenue in fiscal years 2018 and 2017, respectively.

Kennedy Krieger Institute, Inc., Kennedy Krieger Children's Hospital, Inc., Hugo W. Moser Research Institute at Kennedy Krieger, Inc., Kennedy Krieger Education and Community Services, Inc., Kennedy Krieger Associates, Inc., and PACT: Helping Children with Special Needs, Inc. are Maryland non-stock corporations organized for charitable, scientific and educational purposes and are tax-exempt under Section 501(c)(3) of the Internal Revenue Code. Kennedy Krieger Foundation, Inc. (the "Foundation"), is a Maryland stock corporation and is tax-exempt under Section 501(c)(3) of the Internal Revenue Code.

Madison Street Properties, Inc. (“MSP”) is a tax-exempt supporting organization under Section 509(a)(3) of the Internal Revenue Code and is wholly owned by the Foundation. All real and personal property and leasehold rights owned by the Institute are held by MSP, that in turn leases or subleases the property back to each member of the corporate family utilizing it and also provides property management services, including maintenance, security and housekeeping.

The Institute maintains an independent affiliation with The Johns Hopkins University. The formal relationship between the parties is set forth in an affiliation agreement whereby (i) the medical, scientific and other professional staff of the Institute receive primary and adjunct appointments in the appropriate Johns Hopkins University Schools or departments; and (ii) each Institution’s independent corporate status is retained. Goods and services are purchased and sold by each organization through arms length transactions.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Basis of Presentation**
The financial statements of the Institute have been prepared on the accrual basis, which conforms to accounting principles generally accepted in the United States of America. The consolidated financial statements include the accounts of the Institute after elimination of all significant intercompany accounts and transactions.

The consolidating supplemental schedules have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. This is the same basis of presentation as the Kennedy Krieger Institute, Inc. and Affiliates Consolidated Financial Statements

**Excess of Revenue over Expenses**
The Statements of Operations include excess of revenues over (under) expenses, which is the Institute’s performance indicator. Changes in unrestricted net assets, which are excluded from excess of revenues over expenses consistent with industry practice, include unrealized gains and losses on investments, certain pension related transactions and assets acquired using contributions which by donor restrictions were to be used for the purpose of acquiring such assets.

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

**Cash and Cash Equivalents**
Cash and cash equivalents include investments in highly liquid instruments with original maturities of three months or less. These investments are carried at cost, which approximates market value.

**Investments and Investment Income**
Investments in equity securities with readily determinable fair values and all investments in debt securities are classified as trading and are recorded at fair value in the Consolidated Balance Sheets.

Investment income is included in the non-operating activity section of the Statement of Operations. Investment income includes interest and dividends, realized and unrealized gains (losses) on investments.

**Allowance for Doubtful Accounts**

An allowance for doubtful accounts is recorded for patient receivables which are anticipated to become uncollectible in future periods. Receivables deemed to be uncollectible have been written off.

**Grant and Contract Revenue and Receivable**

Grant and contract revenues are recorded through cost reimbursement arrangements when allowable costs are incurred, through service rates as services are provided or when contractual terms are satisfied. Grant and contract receivables are recorded when earned. A reserve for uncollectible accounts has been estimated and recorded against grant and contract receivables.

**Tuition Revenue and Receivable**

Tuition revenue is recognized when earned over the school term (July to June). Tuition receivables are recorded when earned. The Institute does not record an allowance as tuition is paid in full by the local education agencies of the State of Maryland at state approved tuition rates.

**Pledges Receivable**

Unconditional promises to give cash and other assets to the Institute 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 at the date the commitment is received in writing.

Pledges receivable from capital campaigns and other restricted and unrestricted donations, have been recorded net of an allowance for uncollectible pledges. The allowance for uncollectible pledges receivable is estimated based on the nature and source of each pledge including pledge payment history and the donor’s likelihood of honoring the commitment. The allowance is applied to pledges greater than one year. Multi-year pledges are recorded at their estimated present value using a risk-free rate of return of 4% and 3% for 2018 and 2017, respectively.

**Assets Limited as to Use**

Assets limited as to use primarily include assets held by trustees under bond indenture, self-insurance trust arrangements, deferred compensation plans and other restricted gift arrangements.

**Property and Equipment**

Property and equipment acquisitions are recorded at cost. Depreciation is calculated using the straight-line method over the following estimated useful lives:

| | |
|---|---|
| Buildings and Improvements | 30-40 years |
| Fixed Equipment | 10-15 years |
| Furniture and Equipment | 3-5 years |

Equipment purchases under grants, where title to the equipment rests with the grantor, are recorded as expenditures of the grant and are not capitalized or depreciated.

**Capital Leases**

Capital leased assets are amortized over the shorter of their estimated useful lives or the lease term. Depreciation expense on capitalized leased assets is included in depreciation and amortization expenses in the Consolidated Statements of Operations.

**Board Designated Investments for Endowment**
The Board of Directors of the Institute has designated certain assets, including accumulated unrestricted gifts to serve as an endowment for the Institute. The Board may authorize the withdrawal or transfer of such amounts at any time to further the purpose of the Institute and, accordingly, such amounts are classified as unrestricted net assets. Interest, dividends and realized gains and losses from the endowment are included in investment income and net realized gains on the Consolidated Statements of Operations. Unrealized gains and losses are recorded in other changes in unrestricted net assets.

**Deferred Financing Costs**
Costs incurred related to the issuance of bonds payable have been deferred and are being amortized over the life of the bonds using the effective interest method. In fiscal year 2017, the Institute adopted ASU 2015-03, “Simplifying Presentation of Debt Issuance Costs”. These debt issuance costs are now presented as a deduction from the carrying value of the associated debt.

**Accrued Expenses**
Accrued expenses are operating expenses that have been incurred but which have not been paid as of the balance sheet date. These expenses are typically periodic and due within one year or less. They include expenses incurred for payroll, employee benefits, subcontracts, interest and other operating items.

**Deferred Grant Revenue**
Deferred grant revenue has been recorded to reflect the portion of cash received on awarded grants where the grantor restrictions for its use have not been satisfied. Typically, the donor restrictions are satisfied within a year, therefore, deferred grant revenue is classified as a current liability.

**Unrestricted, Temporarily Restricted and Permanently Restricted Net Assets**
Unrestricted net assets represent those net assets utilized in the operating activities of the Institute.

Temporarily restricted net assets are those whose use by the Institute has been limited by donors, grantors and other contracts to a specific purpose or time period. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the Consolidated Statements of Operations as net assets released from restrictions. Restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions in the accompanying financial statements.

Permanently restricted net assets also represent those net assets that have been restricted by donors to be maintained in perpetuity. The donors of these assets usually permit the Foundation to use all or part of the income earned on the investments for general or specific purposes.

**Estimated Professional and General Liability Costs**
The provision for estimated professional and general liability claims includes estimates of the ultimate costs for both reported claims and claims incurred but not reported.

**Derivatives**
The use of derivatives by the Institute is generally limited to interest rate swaps. The Institute follows accounting guidance on derivative financial instruments that are based on whether the derivative instrument meets the criteria for designation as cash flow or fair value hedges. The criteria for designating a derivative as a hedge include the assessment of the instrument’s effectiveness in risk reduction, matching of the derivative instrument to its underlying transaction,

and the assessment of the probability that the underlying transaction will occur. The Institute's only derivative financial instrument is an interest rate swap agreement without hedge accounting designation.

The Institute recognizes its interest rate swap as a liability on the Consolidated Balance Sheet at fair value. The change in the value of this derivative is recorded as an unrealized gain or loss in the Consolidated Statements of Operations.

**Pension Plans**
The Institute follows current technical guidance for reporting and accounting for pension benefits provided to employees. This guidance requires recognition of the funded status of a defined benefit plan in the balance sheet as an asset or liability if the plan is over funded or underfunded, respectively. Changes in the funded status of a plan are required to be recognized in the year in which the changes occur through changes in unrestricted net assets. The guidance also requires the measurement date of the plan's funded status to be the same as the company's fiscal year end.

**Short-term investments**
Short-term investments are carried at fair value and are comprised of instruments with an average duration of 1 to 3 years.

**Investments**
The fair values for marketable equity, government, and fixed income securities included in long-term investments are based on quoted market prices. Alternative investments, which are not readily marketable, are carried at estimated fair values as provided by the investment managers and are valued at the latest available unaudited net asset value of the investments.

**Long-term Debt Obligations**
Management estimates that the fair value of long-term debt is equal to its carrying value.

**Assets Whose Use is Limited**
Assets whose use is limited are comprised of investments held for construction projects, self-insurance obligations, debt service requirements, deferred compensation and donor restricted funds and are valued as stated above.

**Reclassifications**
Certain reclassifications have been made to conform with the current year financial statement presentation.

**New Accounting Pronouncements**
In May 2014, the FASB issued a standard on Revenue from Contracts with Customers. This standard implements a single framework for recognition of all revenue earned from customers. This framework ensures that entities appropriately reflect the consideration to which they expect to be entitled in exchange for goods and services by allocating transaction price to identified performance obligations and recognizing revenue as performance obligations are satisfied. Qualitative and quantitative disclosures are required to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The standard is effective for fiscal years beginning after December 15, 2017. The Institute is evaluating the impact this will have on the consolidated financial statements beginning in fiscal year 2019.

In May 2015, the FASB issued ASU 2015-07, "Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)". ASU 2015-07 removes the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the net asset value per share practical expedient. ASU 2015-07 is required to be applied retrospectively to all periods presented beginning in the year of adoption. The amendments in ASU

2015-07 are effective for years beginning after December 15, 2016. Kennedy Krieger Institute adopted this accounting standard in fiscal year 2017, and there was no impact on the Consolidated Financial Statements. See footnote 8 “Fair Value Measures”.

In April 2015, the FASB issued ASU 2015-03, “Simplifying the Presentation of Debt Issuance Costs”. ASU 2015-03 requires debt issuance costs to be presented in the balance sheet as a direct deduction from the carrying value of the associated debt, consistent with the presentation of a debt discount. Prior to the issuance of the standard, debt issuance costs were required to be presented in the balance sheet as deferred financing charges (i.e., as an asset). Kennedy Krieger Institute adopted this presentation in fiscal year 2017. See footnote 13 “Debt”.

In January 2016, the FASB issued ASU 2016-01, “Financial Instruments-Overall: Recognition and Measurement of Financial Assets and Financial Liabilities”. ASU 2016-01 addresses accounting for equity investments, financial liabilities under the fair value option, and the presentation and disclosure requirements for financial instruments. Non-public business entities will no longer be required to disclose the fair value of financial instruments carried at amortized cost. The amendments in ASU 2016-01 are effective for years beginning after December 15, 2018, and early adoption is permitted. The Institute is evaluating the impact of this update on consolidated financial statements beginning in fiscal year 2020.

In February 2016, the FASB issued a standard on Leases. This standard requires lessees to recognize assets and liabilities for the rights and obligations created by leases with terms in excess of 12 months. The recognition, measurement, and presentation of expenses and cash flows arising from a lease will primarily depend on its classification as a finance or operating lease. The accounting by lessors remains largely unchanged. This standard is effective for fiscal years beginning after December 15, 2018. Kennedy Krieger Institute is evaluating the impact this will have on the consolidated financial statements beginning in fiscal year 2020.

In August 2016, the FASB issued a standard on the Presentation of Financial Statements of Not-for-Profit Entities. The new guidance requires improved presentation and disclosures to help not-for-profits provide more relevant information about their resources to donors, grantor, creditors and other users. The standard is effective for fiscal years beginning after December 15, 2017. Kennedy Krieger Institute is evaluating the impacts this will have on the consolidated financial statements beginning in fiscal year 2019.

In June 2018, the FASB issued ASU 2018-08, “Not-for-Profit Entities (Topic 958), Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made”. The new standard applies to all entities that receive or make contributions. The guidance clarifies the definition of transactions accounted for as an exchange transaction subject to ASU 2014-09 or other applicable guidance, and transactions that should be accounted for as contributions (non-exchange) subject to the contribution accounting model. Further, the guidance provides criteria for evaluating whether contributions are unconditional or conditional. Conditional contributions must specify a barrier that the recipient must overcome and a right of return that releases the donor from its obligation if the barrier is not achieved, otherwise the contribution is unconditional. The update is effective for fiscal years beginning after June 15, 2018, with early adoption permitted. The institute is evaluating the impact of this update on consolidated financial statements beginning in fiscal year 2019, and believes there will be no significant impact.

**(in thousands)**

## 3. NET PATIENT SERVICE REVENUE AND ALLOWANCE FOR DOUBTFUL ACCOUNTS

Net patient service revenues from inpatient and outpatient services are reported at estimated net realizable amounts from patients, third-party payors, and others for services rendered including estimates for contractual allowances with third-party payors and bad debts.

The Institute has agreements with third-party payors that provide for payments to the Institute at amounts different from its established rates. Net patient service revenue is comprised of the following:

| | 2018 | 2017 |
|---|---|---|
| Gross Inpatient Revenue | $ 59,850 | $ 57,365 |
| Less: Contractual Allowances | (11,482) | (10,960) |
| Bad Debt Expense | (703) | (570) |
| Net Inpatient Revenue | 47,665 | 45,835 |
| Gross Outpatient Revenue | 135,857 | 130,005 |
| Less: Contractual Allowances | (13,632) | (12,180) |
| Bad Debt Expense | (3,725) | (3,013) |
| Net Outpatient Revenue | 118,500 | 114,812 |
| Net Patient Service Revenue | $ 166,165 | $ 160,647 |

The percentage of patient service revenue generated by payor category for the fiscal years ended June 30, 2018 and 2017 is as follows:

| | 2018 | 2017 |
|---|---|---|
| Medicaid | 35% | 36% |
| Blue Cross | 23% | 25% |
| Commerical | 25% | 21% |
| Managed Care | 14% | 13% |
| Self pay and other | 1% | 3% |
| Medicare | 2% | 2% |
| | 100% | 100% |

The Allowance for Doubtful Accounts is based upon management's assessment of historical and expected net collections considering trends in healthcare coverage, economic conditions and payor mix. Management assesses the adequacy of the allowance periodically based upon historical collection and write off experience. After collection of amounts due from insurers, the Institute follows internal guidelines for placing certain past-due balances with collection agencies.

**(in thousands)**

| | 2018 | 2017 |
|---|---|---|
| Beginning Allowance for doubtful accounts | $ 4,715 | $ 3,750 |
| Plus: Bad debt expense | 4,428 | 3,583 |
| Less: Bad debt write-offs, net of recoveries | (3,614) | (2,618) |
| Ending Allowance for doubtful accounts | $ 5,529 | $ 4,715 |

A summary of the payment arrangements with major third-party payors and patient financial assistance follows.

**Maryland Medicaid**
Since January 1, 2007 the Institute has been under a prospective payment system ("PPS") with Maryland Medicaid for both inpatient and outpatient services. Service-based per diem rates for inpatient services are annually adjusted by market basket update factors published by the Centers for Medicare and Medicaid Services ("CMS"). Outpatient services are reimbursed as a percentage of charges and subject to the lower of cost versus charges. Base year costs are trended forward annually using the CMS outpatient PPS market basket update factor and compared to actual charges. No retroactive settlement occurs under these arrangements.

**Out of State Medicaid**
The Institute has entered into payment agreements with many out-of-state Medicaid Plans. The majority of these payment agreements reflect similar rates paid by Maryland Medicaid. No retroactive settlement occurs under these agreements.

**Commercial Insurance**
The Institute has also entered into payment agreements with commercial insurance carriers, health maintenance organizations and preferred provider organizations. The basis of payment to the Institute under these agreements includes prospectively determined rates per day or discharge, discounts from established charges and prospectively determined daily rates. No retroactive settlement occurs under these agreements.

**Medicare**
Certain inpatient and outpatient services rendered to Medicare beneficiaries are subject to retrospective cost-based reimbursement. Medicare cost reports have been filed through 2017 and final settled through 2015. No significant settlement due to or from the Medicare Program has been estimated and as a result no receivable or payable has been recorded at June 30, 2018 or 2017.

**Financial Assistance and Community Benefit**
The Institute provides services without charge or at discounted charges to patients who meet certain criteria under its financial assistance policy. The criteria for financial assistance considers the patient or patient's family's ability to pay at time of service. The Institute uses the federal poverty guidelines to determine eligibility for free care or discounted care. In addition, the Institute's policy applies to patients who are medically indigent. The Institute also offers payment plan options to assist patients who experience a financial hardship paying their hospital and professional services bills, but who might not qualify for financial assistance. In January 2016, the Institute expanded its financial assistance policy along with developing a plain language summary of the policy that is distributed to patients at registration.

**(in thousands)**

The cost for services and supplies furnished under the Institute’s financial assistance policy aggregated approximately $1,079 and $988 in 2018 and 2017, respectively. The cost has been estimated based on a cost to charge ratio and applied to financial assistance charges.

In addition to patient financial assistance and payment plan options, the Institute provides various community benefits across the developmental disability populations within the State of Maryland. The foundation of its community benefits envisions that all persons with developmental disabilities (“DD”) lead fully inclusive and meaningful lives. A community needs assessment was conducted to understand the needs of the community served. Based on the needs assessment, the Institute promotes and hosts educational forums, provides respite care resources, acts as a resource finder, provides advocacy and legal services, promotes and arranges information exchange among patients, families and professionals, promotes workforces development, is a leader in healthcare training in DD, conducts research, among other things.

## 4. TUITION REVENUE

Tuition revenue generated by school programs is summarized as follows:

| | 2018 | 2017 |
|---|---|---|
| High school | $ 14,765 | $ 13,925 |
| Lower/middle school | 14,026 | 13,089 |
| Leap/Autism | 7,426 | 7,917 |
| Montgomery County | 6,642 | 5,686 |
| Partnership programs | 5,373 | 5,463 |
| PACT daycare | 659 | 748 |
| Other | 53 | 42 |
| | $ 48,944 | $ 46,870 |

Over 570 students are enrolled in special education programs each year and come from fourteen Maryland counties, Washington, D.C. and other sources. The percentage of tuition revenue generated by jurisdiction is as follows:

| | 2018 | 2017 |
|---|---|---|
| Prince George's County, MD | 22.3% | 21.8% |
| Other MD Counties | 18.4% | 19.5% |
| Baltimore City, MD | 17.4% | 18.7% |
| Baltimore County, MD | 14.3% | 15.1% |
| Anne Arundel County, MD | 12.8% | 11.4% |
| Montgomery County, MD | 8.3% | 8.6% |
| Washington, DC | 5.9% | 4.2% |
| Other | 0.6% | 0.7% |
| Total | 100.0% | 100.0% |

(in thousands)

## 5. GRANT AND CONTRACT REVENUE

Grant and contract revenue is generated through the following activities:

| | 2018 | 2017 |
|---|---|---|
| Research | $ 26,130 | $ 28,588 |
| Community service | 6,177 | 6,294 |
| Training | 1,642 | 1,636 |
| | $ 33,949 | $ 36,518 |

Research revenue includes all research initiatives funded through government and private sources. Community service revenue consists of services provided to individuals and families with special needs in a community-based setting and is funded through government programs. Training revenue represents government funding of training programs for professionals in the field of developmental disabilities.

Grant and contract revenue includes recoveries of facility and administrative costs, with certain limitations and exclusions. Certain revenues and costs in current and prior years are subject to audit and retroactive settlement. No reserve has been recorded for any potential settlements as amounts are not known or are considered immaterial.

## 6. CONTRIBUTIONS FROM FUNDRAISING ACTIVITIES

During 2018 and 2017, the Institute recognized contributions from fundraising activities as summarized below:

| | 2018 | 2017 |
|---|---|---|
| Contributions | | |
| Temporarily Restricted | $ 6,620 | $ 4,987 |
| Unrestricted | 1,623 | 1,102 |
| Total Contributions | 8,243 | 6,089 |
| Fundraising expenses | | |
| Unrestricted | 2,015 | 2,041 |
| Restricted | 1,185 | 988 |
| Total Expenses | $ 3,200 | $ 3,029 |

Restricted contributions are made up of annual giving and capital campaign contributions which are classified as temporarily restricted net assets on the Consolidated Balance Sheets. Permanently restricted contributions reflect gifts where the corpus cannot be utilized but where investment earnings are available for use. These contributions are classified as permanently restricted net assets on the Consolidated Balance Sheets. Unrestricted contributions reflect gifts with no donor restrictions and are reported on the Consolidated Statements of Operations.

Fundraising expenses are reported as operating expenses for those expenses related to unrestricted contributions and non-operating expenses for those expenses related to restricted contributions. Expenses related specifically to special events are netted with the revenue from those events.

**(in thousands)**

## 7. INVESTMENTS AND INVESTMENT INCOME

Investments at June 30, 2018 and 2017 consist of the following:

| | 2018 | 2017 |
|---|---|---|
| Board designated endowment | | |
| Fixed income mutual funds | $ 16,251 | $ 13,403 |
| Equity mutual funds | 39,156 | 38,170 |
| Absolute return fund | 508 | 654 |
| Total Board designated endowment | 55,915 | 52,227 |
| Investments limited as to use | | |
| Money market funds | 7,701 | 9,800 |
| Fixed income mutual funds | 2,077 | 17,039 |
| Equity securities and funds | 5,663 | 5,354 |
| Total assets limited to use | 15,441 | 32,193 |
| Total Investments | $ 71,356 | $ 84,420 |

### Board Designated for Endowment

The Institute maintains certain investments as Board designated for endowment ("endowment funds"). These endowment funds are made up of unrestricted gifts and bequests and certain reserve funds. They have been set aside by the Institute's Board of Directors to fund new initiatives and other needs necessary in furtherance of the mission of the Institute and its subsidiary entities. The Board of Directors maintains the power to release these funds. The endowment funds are classified within unrestricted net assets.

Changes in endowment funds held by the Institute at June 30, 2018 and 2017 are as follows:

| | 2018 | 2017 |
|---|---|---|
| Board Designated Endowment, beginning of year | $ 52,227 | $ 45,836 |
| Investment return: | | |
| Unrealized gains | 2,478 | 5,560 |
| Realized gains | 776 | 17 |
| Investment income, net | 1,446 | 1,320 |
| Total investment return | 4,700 | 6,897 |
| Investment earnings appropriated for operating activities | (2,022) | (2,000) |
| Amount of investment earnings payable | 1,010 | 1,494 |
| Endowment, end of year | $ 55,915 | $ 52,227 |

**(in thousands)**

The Investment Committee of the Board of Directors ("Investment Committee") sets the investment policy for the endowment funds, including investment and spending guidelines. Investments of the endowment funds are based on the objective of achieving capital appreciation and investment income. Assets are invested in a manner that is intended to achieve an average annual real return in excess of inflation while assuming an acceptable level of investment risk. To monitor the effectiveness of the investment strategy of endowment funds, performance goals are established and monitored related to benchmark indices and returns earned by comparable funds.

To satisfy its long-term rate of return objectives of the endowment funds, the Institute employs a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current income (interest and dividends). The investment policy includes a target asset allocation that is well diversified among suitable asset classes and that is expected to generate, on average, the level of expected return necessary to meet the endowment fund's objectives while assuming a level of risk (volatility) consistent with achieving that return.

In September 2015, the Investment Committee of the Board of Directors voted to move the Endowment, Pension and Self-Insured Trust Fund investments to a new investment manager; Vanguard Institutional Advisory Services. The move was completed in December 2015 in which all assets were liquidated with the old manager and invested with Vanguard with the exception of the Absolute return fund.

The asset allocation of the endowment funds at June 30, 2018 and 2017 is summarized below. The Investment Committee regularly reviews the actual asset allocation against the target and periodically rebalances the investment, as appropriate.

| | **Target** | **Actual Allocation** | |
|---|---|---|---|
| | **Allocation** | **2018** | **2017** |
| Equities | 70% | 70% | 73% |
| Fixed income | 30% | 29% | 26% |
| Absolute return funds | - | 1% | 1% |
| | 100% | 100% | 100% |

The investment policy also provides for an endowment earnings withdrawal to be used in support of operating activities, as determined by Institute management and approved through the annual budget. The annual withdrawal is determined based on 4% of the three-year average market value of the portfolio. Withdrawals of $1,012 and $506 were made in 2018 and 2017, respectively to fund operating needs and have been reported as operating revenues.

Investments with a market value of $1,391 and $1,379 as of June 30, 2018 and 2017, respectively have been pledged as collateral under the Institute's self-funded unemployment insurance plan.

(in thousands)

**Investments Limited As To Use**

Investments limited as to use at June 30, 2018 and 2017 are made up of the following:

| | 2018 | 2017 |
|---|---|---|
| Construction funds (bonds and donor cash) | $ 7,138 | $ 23,635 |
| Self insurance trust fund | 4,212 | 3,959 |
| Deferred compensation | 1,949 | 1,637 |
| Capital interest fund | 537 | 1,308 |
| Permanently restricted fund | 1,045 | 1,110 |
| Planned gifts, net of reserve | 265 | 249 |
| Donor advised fund | 295 | 295 |
| Total investments limited as to use | 15,441 | 32,193 |
| Less current portion | 7,676 | 24,943 |
| Long-term portion | $ 7,765 | $ 7,250 |

**Investment Income and Gains and Losses**

Investment income and gains and losses are comprised of the following:

| | 2018 | 2017 |
|---|---|---|
| Investment income | | |
| Interest and dividend income | $ 1,671 | $ 1,394 |
| Realized gain on investments, net | 694 | 72 |
| Less: Investment earnings appropriated for operating activites | (2,022) | (2,000) |
| Net investment income | $ 343 | $ (534) |
| Net unrealized gain on investments | $ 2,796 | $ 6,053 |

The Institute reviews investments to determine whether these investments are other-than-temporarily impaired. Factors considered in the evaluation of these assets include the anticipated holding period, the extent and duration of below cost valuation and the current condition and outlook of the business and industry. As a result of this assessment, no impairment losses were recognized in 2018 and 2017.

The following table presents the fair value and unrealized loss of the Institute's investments including unrealized losses that are not deemed other-than-temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at June 30, 2018.

**(in thousands)**

| | Less than 12 Months | | 12 Months or Greater | | Total | |
|---|---|---|---|---|---|---|
| Description | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| Fixed income securities | $14,734 | $ (408) | $ - | $ - | $ 14,734 | $ (408) |
| Equity securities | 50 | (2) | - | - | 50 | (2) |
| Total | $14,784 | $ (410) | $ - | $ - | $ 14,784 | $ (410) |

These securities represented nine fixed income securities and two equity securities. The Institute evaluated the near-term prospects of the issuers of each of these funds in relation to the severity and duration of the impairment. Based upon this evaluation and the Institute's intent to hold these investments for a reasonable period of time for a forecasted recovery of fair value, the Institute does not consider these investments to be other-than-temporarily impaired at June 30, 2018.

## 8. FAIR VALUE MEASUREMENTS

FASB's guidance on the fair value option for financial assets and financial liabilities permits companies to choose to measure many financial assets and liabilities, and certain other items at fair value. This guidance requires a company to record unrealized gains and losses on items for which the fair value option has been elected in its performance indicator. The fair value option may be applied on an instrument by instrument basis. Once elected, the fair value option is irrevocable for that instrument. The fair value option can be applied only to entire instruments and not to portions thereof. Kennedy Krieger Institute has not elected fair value accounting for any asset or liability that is not currently required to be measured at fair value.

Kennedy Krieger Institute follows the guidance on fair value measurements, which defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, establishes a framework for measuring fair value, and expands disclosures about such fair value measurements. This guidance applies to other accounting pronouncements that require or permit fair value measurements and, accordingly, this guidance does not require any new fair value measurements.

This guidance discusses valuation techniques such as the market approach, cost approach and income approach. The guidance establishes a three-tier level hierarchy for fair value measurements based upon the transparency of inputs used to value an asset of liability as of the measurement date. The three-tier hierarchy prioritizes the inputs used in measuring fair value as follows:

- Level 1 – Observable inputs such as quoted market prices for identical assets or liabilities in active markets;
- Level 2 – Observable inputs for similar assets or liabilities in an active market, or other than quoted prices in an active market that are observable either directly or indirectly; and
- Level 3 – Unobservable inputs in which there is little or no market data that requires the reporting entity to develop its own assumptions.

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

**(in thousands)**

The following tables present the fair value of investments and liabilities as of June 30, 2018 and June 30, 2017, by the valuation hierarchy defined above and also presents information on the liquidity aspects of each investment.

Fair Value of Investments
as of June 30, 2018

| | Level 1 | Level 2 | Level 3 | Total Fair Value |
|---|---|---|---|---|
| Investments: | | | | |
| Money market funds (1) | $ 7,701 | | | $ 7,701 |
| Fixed income mutual funds (2) | 18,328 | | | 18,328 |
| Equity securities and funds (3) | 44,524 | | | 44,524 |
| Alternative investments (4) | | | 803 | 803 |
| Total Investments | $ 70,553 | $ - | $ 803 | $ 71,356 |
| Liabilities: | | | | |
| Interest rate swap | $ - | $ 6,320 | $ - | $ 6,320 |
| Total Liabilities | $ - | $ 6,320 | $ - | $ 6,320 |

Fair Value of Investments
as of June 30, 2017

| | Level 1 | Level 2 | Level 3 | Total Fair Value |
|---|---|---|---|---|
| Investments: | | | | |
| Money market funds (1) | $ 9,800 | $ - | $ - | $ 9,800 |
| Fixed income mutual funds (2) | 30,442 | - | - | 30,442 |
| Equity securities and funds (3) | 43,229 | - | - | 43,229 |
| Alternative investments (4) | - | - | 949 | 949 |
| Total Investments | $ 83,471 | $ - | $ 949 | $ 84,420 |
| Liabilities: | | | | |
| Interest rate swap | $ - | $ 8,545 | $ - | $ 8,545 |
| Total Liabilities | $ - | $ 8,545 | $ - | $ 8,545 |

(1) Money market funds include investments in short-term debt securities, including US Treasury bills and commercial paper with same day or next day liquidity.

(2) Fixed income mutual funds include funds whose underlying investments include domestic and international corporate bonds, obligations issued or guaranteed by the U.S. government or its agencies, bankers acceptances, bank certificates of deposit, repurchase agreements, commercial paper, fixed income instruments denominated in currencies of emerging market countries and fixed income instruments represented by forwards or derivatives including options, future contracts and swap agreements. All funds offer next day liquidity. All funds are traded in active markets.

**(in thousands)**

(3) Equity funds include investments in common stock mutual funds with next day liquidity.

(4) Alternative investments include investments in a pooled investment fund of funds with underlying investments in equity long and short positions, distressed credit and private investments. Distributions from the fund have been limited by the fund of funds manager. In addition, privately held common stock of a privately held company is included. There is currently no market for the common stock.

The Institute has also classified the valuation of its interest rate swap in Level 2 of the fair value hierarchy. For over-the-counter derivatives that trade in liquid markets, such as interest rate swaps, model inputs (i.e. contractual terms, market prices, yield curves, credit curves, and measures of volatility) can generally be verified, and model selection does not involve significant management judgment.

## 9. PROPERTY AND EQUIPMENT

A summary of property and equipment at June 30, 2018 and 2017 is as follows:

| | 2018 | 2017 |
|---|---|---|
| Land | $ 4,657 | $ 4,657 |
| Building and improvements | 168,335 | 166,339 |
| Furniture & equipment | 44,960 | 42,308 |
| | 217,952 | 213,304 |
| Less: Accumulated depreciation | (106,695) | (97,552) |
| | 111,257 | 115,752 |
| Construction in progress | 33,977 | 5,947 |
| Property and equipment, net | $ 145,234 | $ 121,699 |

Depreciation expense was $9,159 and $9,473 in 2018 and 2017, respectively.

Construction of an 8-story, 130,000 square foot building located in the 800 block of N. Broadway adjacent to the current outpatient clinical care building and parking garage began in the fall of 2017 to house clinical programs and support services. The building is expected to cost $48.5 million and be completed by the end of 2018.

The construction of the building is being financed through the Series 2017A Bonds as further described in Note 13 along with state and private support. Interest incurred during the construction is being capitalized as part of the project costs and totaled $537 and $1,308 in 2018 and 2017, respectively.

**(in thousands)**

**Capital Lease Obligations**

The Institute entered into a lease agreement in May 2016 for computer equipment with a value of $1.1 million and a lease term of four years. The Institute recorded the equipment as a capital lease and is reflected in property and equipment on the Consolidated Balance Sheets.

The future minimum lease payments required under the capital lease are as follows:

| | | |
|---|---|---|
| 2019 | $ | 386 |
| 2020 | | 354 |
| Total future minimum lease payments | $ | 740 |

## 10. PLEDGES RECEIVABLE

Pledges receivable at June 30, 2018 and 2017 are summarized below:

| | 2018 | 2017 |
|---|---|---|
| Total pledges receivable | $ 15,009 | $ 18,830 |
| Less: Present value adjustment | (644) | (971) |
| Allowance for uncollectible pledges | (1,564) | (1,590) |
| Net pledges receivable | 12,801 | 16,269 |
| Less: Pledges due within one year | (9,038) | (7,410) |
| Pledges due in one to five years | $ 3,763 | $ 8,859 |

The present value adjustments for 2018 and 2017 were made utilizing discount rates in effects at the time of the gift. The allowance for uncollectible pledges has been estimated based on management evaluation of each pledge's likelihood to be collected and using historical pledge write-off rates.

## 11. SIGNIFICANT CONCENTRATIONS OF CREDIT RISK

Financial instruments which potentially subject the Institute to concentrations of credit risk consist primarily of cash and cash equivalents, investments and patient accounts receivable.

The Institute typically maintains cash and cash equivalents in commercial banks. The short-term investments consist primarily of money market funds. The Federal Deposit Insurance Corporation insures funds up to $250,000 per depositor.

The fair value of the Institute's investments are subject to various market fluctuations which include changes in the interest rate environment and general economic conditions.

The Institute records patient receivables due for services provided to patients and others. The majority of these patients either qualify for federal/state assistance programs or have insurance through commercial insurance companies or managed care organizations. The Institute maintains reserves for potential losses and such losses have been within management's expectations. The mix of patient receivables due from patients and third-party payors at June 30, 2018 and 2017 are as follows:

**(in thousands)**

| | 2018 | 2017 |
|---|---|---|
| Medicaid | 10.0% | 12.3% |
| Medicaid Managed Care Organizations | 12.3% | 12.1% |
| Total Medical Assistance | 22.3% | 24.4% |
| Commercial Insurance | 39.2% | 33.5% |
| Blue Cross | 19.3% | 22.2% |
| Managed Care | 11.7% | 11.9% |
| Self-pay and other | 5.7% | 6.5% |
| Medicare | 1.8% | 1.5% |
| | 100.0% | 100.0% |

## 12. ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Accounts payable and accrued expenses at June 30, 2018 and 2017 are made up of the following:

| | 2018 | 2017 |
|---|---|---|
| Accounts payable and other accrued expenses | $ 14,978 | $ 12,941 |
| Payroll | 8,229 | 7,581 |
| Vacation | 5,322 | 4,917 |
| Workers' compensation, unemployment and health benefits | 2,756 | 2,686 |
| Self-insurance - general/professional liability | 1,594 | 1,431 |
| Research subcontracts | 1,228 | 684 |
| | $ 34,107 | $ 30,240 |

## 13. DEBT

**Tax-exempt Bonds**

Tax-exempt bonds issued through Maryland Health and Higher Educational Facilities Authority (“MHHEFA”) at June 30, 2018 and 2017 consisted of the following:

| | 2018 | 2017 |
|---|---|---|
| MHHEFA Series 2011 Bonds | $ 16,543 | $ 17,240 |
| MHHEFA Series 2012 Bonds | 1,599 | 2,785 |
| MHHEFA Series 2013 Bonds | 16,085 | 16,100 |
| MHHEFA Series 2017A Bonds | 23,000 | 23,000 |
| MHHEFA Series 2017B Bonds | 26,931 | 27,395 |
| | 84,158 | 86,520 |
| Less: Current portion | (3,125) | (2,361) |
| Less: Unamortized deferred financing costs | (630) | (686) |
| | $ 80,403 | $ 83,473 |

**(in thousands)**

The Series 2011 Bonds are privately placed with Bank of America through a $19,610 non-bank qualified term loan with a maturity date of June 1, 2021. The loan is being amortized through July 1, 2036. Terms of the loan agreement call for interest to be paid based on a percentage of 30-day LIBOR plus a bank spread. Principal payments are due in monthly installments on the first day of each month.

The Series 2012 Bonds were privately placed in October 2012 with BB&T through a $7,880 non-bank qualified term loan with a maturity date of July 1, 2019. The loan is also being amortized through the same period. Principal and interest are due in monthly installments on the first day of each month. Terms of the loan agreement call for a fixed interest rate of 2.21%.

The Series 2013 Bonds issued through MHHEFA were privately placed with Bank of America through a $16,730 non-bank qualified term loan with a maturity date of July 1, 2023. The loan is being amortized through July 1, 2033. Principal and interest are due in monthly installments on the first day of each month. Terms of the loan call for a fixed interest rate of 3.62%.

The Series 2017A Bonds issued through MHHEFA were privately placed in March 2017 with CapitalOne Municipal Funding through a $23,000 non-bank qualified term loan with a maturity date of April 1, 2027. The loan is being amortized through March 1, 2042. Principal and interest payments are due in monthly installments on the first day of each month. Principal payments do not begin until April 1, 2019. Terms of the loan agreement called for a fixed rate of interest of 3.21%. Due to the change in the maximum federal corporate tax rate, the loan agreement was amended in May 2018, for a fixed rate of interest of 3.79%.

The Series 2017B Bonds issued through MHHEFA were privately placed with BB&T through a $27,510 non-bank qualified term loan with a maturity date of April 1, 2027. The loan is being amortized through March 1, 2037. Terms of the loan agreement call for interest to be paid based on a percentage of 30-day LIBOR plus a bank spread. Principal and interest payments are due in monthly installments on the first day of each month.

The obligated group for the Series 2011, 2012, 2013 and 2017A and B Bonds (the “Bonds”) include Kennedy Krieger Institute, Inc. and each of its affiliated entities. The Bonds were issued in parity and contain certain restrictions on the Institute’s ability to incur additional indebtedness, restrict its use of facilities, maintain stipulated insurance coverage and maintain a rate structure sufficient to meet its total annual cash requirements. The Institute must maintain compliance with certain financial covenants contained in the bond indentures and loan agreements.

At June 30, 2018 and 2017, the Institute was in compliance with all covenants in accordance with these agreements.

The aggregate future maturities of bonds payable for the next five years and thereafter are summarized below at June 30, 2018.

| | | |
|---|---|---|
| 2019 | $ | 3,125 |
| 2020 | | 3,204 |
| 2021 | | 3,291 |
| 2022 | | 3,384 |
| 2023 | | 3,471 |
| Thereafter | | 67,683 |
| | $ | 84,158 |

Unamortized deferred bond financing costs of $630 in 2018 and $686 in 2017 are netted against tax-exempt bonds. Amortization expense was $55 and $35 in 2018 and 2017, respectively. A loss on the early extinguishment of long-term debt associated with the refunding of the 2010 Bonds was recorded in 2017 in the amount of $167.

**Line of Credit**
The Institute maintains a working capital line of credit with Bank of America. The committed amount under the line of credit is $10,000 and is committed through December 31, 2018. The balance on the line of credit was $0 at June 30, 2018 and 2017. The line of credit is secured by a pledge on the revenues of the Institute and the financial covenant requirements are consistent with those of the Series 2011 and 2013 Bonds held by the bank.

## 14. RETIREMENT PLANS

The Institute maintains defined benefit and defined contribution plans covering substantially all of its employees.

**Defined Benefit Plan**
The Institute's defined benefit pension plan (the "plan") provides benefits to staff-level employees based on years of service and the employees' final average compensation. The Institute's policy is to annually fund the amount necessary to meet minimum funding requirement under ERISA. Contributions of $2,111 and $1,900 were made for 2018 and 2017, respectively.

The net periodic benefit cost calculated in accordance with current guidance for employer's accounting for pension obligations is $2,381 and $2,479 for 2018 and 2017, respectively.

The following table sets for the plan's funded status and benefit obligations recognized in the Institute's financial statements at June 30, 2018 and 2017:

**(in thousands)**

| | 2018 | 2017 |
|---|---|---|
| Change in benefit obligation: | | |
| Projected benefit obligation at beginning of year | $ 56,695 | $ 56,876 |
| Service cost | 615 | $ - |
| Interest cost | 2,274 | 2,229 |
| Actuarial loss (gain) | (2,242) | (1,089) |
| Benefits paid | (2,470) | (1,321) |
| Projected benefit obligation at end of year | $ 54,872 | $ 56,695 |
| Change in plan assets: | | |
| Fair value of plan assets at beginning of year | $ 38,502 | $ 34,359 |
| Actual return on plan assets | 1,989 | 3,564 |
| Employer contribution | 2,111 | 1,900 |
| Benefits paid | (2,470) | (1,321) |
| Fair value of plan assets at end of year | $ 40,132 | $ 38,502 |
| Funded status at end of year | $ (14,740) | $ (18,193) |
| Recognized in noncurent liabilities | | |
| Amounts not yet recognized in net periodic benefit cost and included in unrestricted net assets: | | |
| Accumulated actuarial loss | $ (16,937) | $ (20,660) |
| Net unrestricted net assets previously reflected | 2,197 | 2,467 |
| Net amount recognized | $ (14,740) | $ (18,193) |
| Components of net periodic pension cost: | | |
| Service cost | $ 615 | $ - |
| Interest cost | 2,274 | 2,229 |
| Expected return on plan assets | (2,382) | (2,234) |
| Loss on amortization | 1,874 | 2,484 |
| Net periodic pension cost | $ 2,381 | $ 2,479 |
| Changes in net assets not yet reflected in the statement of operations: | | |
| Unrecognized net loss (gain) | $ (1,849) | $ (2,418) |
| Amortization of unrecognized net loss | (1,874) | (2,484) |
| Total changes in plan assets and obligations not yet reflected | $ (3,723) | $ (4,902) |
| Total changes in plan assets and benefit obligations | $ (1,342) | $ (2,423) |
| Unrecognized net loss to be amortized over next fiscal year | $ (1,432) | $ (1,874) |

**(in thousands)**

| | 2018 | 2017 |
|---|---|---|
| Additional information: | | |
| Accumulated benefit obligation | $ 54,872 | $ 56,694 |
| Expected contributions in the following year | $ 2,775 | $ 2,100 |

Expected benefit payments for fiscal year ending June 30, 2018:

| | |
|---|---|
| 2019 | $ 1,882 |
| 2020 | 1,925 |
| 2021 | 2,095 |
| 2022 | 3,264 |
| 2023 | 2,378 |
| Next five years | 13,491 |

| **Weighted-average assumptions to determine benefit obligations:** | **2018** | **2017** |
|---|---|---|
| Discount rate | 4.33% | 4.07% |
| Salary increase | Non applicable | Non applicable |
| Measurement date | June 30 | June 30 |
| Participant census data used | January 1, 2018 | January 1, 2017 |

| **Weighted-average assumptions to determine pension expense:** | **2018** | **2017** |
|---|---|---|
| Discount rates | 4.07% | 3.97% |
| Expected return on plan assets | 6.25% | 6.50% |
| Salary increase | Non applicable | Non applicable |

The discounted rate assumption for fiscal years ending 2018 and 2017 were determined using the actuary's proprietary yield curve, under which the plan's projected benefit payments are matched against a series of spot rates derived from a market basket of high quality fixed income securities.

In determining the expected long-term rate of return on plan assets, the Institute evaluated the historical long-term rate of return for each class of asset in the plan and utilized a proprietary portfolio return calculator in determining an acceptable range of expected returns.

The following tables present fair value measurements for plan assets as of June 30, 2018 and 2017 by the valuation hierarchy as defined in footnote 8 and also includes the liquidity aspects of each investment:

**(in thousands)**

Fair Value of Investments
as of June 30, 2018

| | Level 1 | Level 2 | Level 3 | Total Fair Value |
|---|---|---|---|---|
| Investments: | | | | |
| Money market funds (1) | $ 218 | $ - | $ - | $ 218 |
| Fixed income mutual funds (2) | 13,885 | - | - | $ 13,885 |
| Equity securities and funds (3) | 25,829 | - | - | 25,829 |
| Alternative investments (4) | - | - | 200 | 200 |
| Total Investments | $ 39,932 | $ - | $ 200 | $ 40,132 |

Fair Value of Investments
as of June 30, 2017

| | Level 1 | Level 2 | Level 3 | Total Fair Value |
|---|---|---|---|---|
| Investments: | | | | |
| Fixed income mutual funds (2) | $ 13,323 | $ - | $ - | $ 13,323 |
| Equity securities and funds (3) | 24,926 | - | - | 24,926 |
| Alternative investments (4) | - | - | 253 | 253 |
| Total Investments | $ 38,249 | $ - | $ 253 | $ 38,502 |

(1) Money market funds include investments in short-term debt securities, including US Treasury bills and commercial paper with same day or next day liquidity.

(2) Fixed income mutual funds include funds whose underlying investments include domestic and international corporate bonds, obligations issued or guaranteed by the U.S. government or its agencies, bankers acceptances, bank certificates of deposit, repurchase agreements, commercial paper, fixed income instruments denominated in currencies of emerging market countries and fixed income instruments represented by forwards or derivatives including options, future contracts and swap agreements. All funds offer next day liquidity. All funds are traded in active markets.

(3) Equity funds include investments in common stock mutual funds with next day or monthly liquidity.

(4) Alternative investments include investments in a pooled investment fund of funds with underlying investments in equity long and short positions, distressed credit and private investments. Distributions from the fund have been limited by the fund of funds manager. In addition, privately held common stock of a privately held company is included. There is currently no market for the common stock.

(in thousands)

The plan's target allocations and actual asset allocation at June 30, by asset category, was as follows:

| | Target Allocation | Actual Allocation 2018 | 2017 |
|---|---|---|---|
| Money market funds | - | 0.5% | - |
| Equities | 65% | 64.4% | 65% |
| Fixed income | 35% | 34.6% | 34% |
| Absolute return funds | - | 0.5% | 1% |
| | 100% | 100% | 100% |

The objectives of the plan's investment strategy are to maximize the plan's funded status and minimize the Institute's contributions and plan expense.

The Investment Committee establishes a target asset allocation and regularly reviews the actual asset allocation against the target. It also periodically rebalances the investment allocations, as appropriate.

**Defined Contribution Plan**
The Institute maintains a qualified defined contribution retirement plan which is in compliance with section 401(k) of the Internal Revenue Code (IRC). The 401(k) plan is active and available to all employees (including all faculty and senior staff members) and provides for up to a 50% employer match on employee contributions up to certain levels of compensation. During 2018 and 2017, the aggregate contributions to the 401(k) plan were $18,025 and $16,293.

**Deferred Compensation Plan**
The Institute also offers a non-qualified deferred compensation plan (457(b) of the IRC) for certain of its executives which allows for the deferral of compensation up to IRS limits. A deferred balance of $1,949 and $1,637 in fiscal years 2018 and 2017, respectively, was reported in Investments limited as to use in the Consolidated Balance Sheet. An associated liability of an equal amount is included in Other long-term liabilities in the Consolidated Balance Sheet. The Institute makes no contributions to the Deferred Compensation Plan.

## 15. INTEREST RATE SWAP

The Institute manages the fixed/variable mix of its debt portfolio, including hedging exposure to increasing interest expense on variable rate debt, by utilizing an interest rate swap. The Institute maintains a fixed payor interest rate swap which hedges the variable interest rate risk on the majority of the outstanding balance of the Series 2017B and 2011 Series Bonds. Under the terms of the agreement with a local bank, the Institute pays a fixed rate of 3.636% and receives 67% of 30-day LIBOR on notional amounts that reduce annually until July 2036. Notional amounts of $36,659 and $37,273 were effective June 30, 2018 and 2017, respectively. Under the terms of the agreement, no collateral requirements exist on the part of the Institute.

The fair value of the interest rate swap and the related unrealized (losses) were as follows as of June 30, including the classification on the Consolidated Balance Sheets and Statements of Operations:

**(in thousands)**

| | Fair Market Value | |
|---|---|---|
| | **2018** | **2017** |
| Interest rate swap liability | $ 6,320 | $ 8,545 |

| | Amount recognized in Non-operating activity | |
|---|---|---|
| | **2018** | **2017** |
| Unrealized gain (loss) on interest rate swap valuation | $ 2,225 | $ 3,825 |
| Interest rate swap payments | (955) | (1,175) |
| Total | $ 1,270 | $ 2,650 |

## 16. TEMPORARILY AND PERMANENTLY RESTRICTED NET ASSETS

Temporarily restricted net assets were held for the following purposes at June 30, 2018 and 2017:

| | **2018** | **2017** |
|---|---|---|
| Capital Campaigns | $ 15,684 | $ 18,579 |
| Research and clinical projects | 19,182 | 18,491 |
| | $ 34,866 | $ 37,070 |

During 2018 and 2017, restricted net assets were released by satisfying donor restrictions in the following amounts:

| | **2018** | **2017** |
|---|---|---|
| Property and equipment | $ 5,005 | $ 1,414 |
| Operating activities | 3,819 | 4,168 |
| Total | $ 8,824 | $ 5,582 |

Permanently restricted net assets were held in perpetuity for the following purpose at June 30, 2018 and 2017:

| | **2018** | **2017** |
|---|---|---|
| Inperpetuity for the Physically Challenged Sports Program | $ 958 | $ 958 |

### 17. SELF INSURANCE

**Professional and General Liability**

The Institute maintains a self-insurance trust (the "Trust") for general and professional liability to cover liability claims arising out of the ordinary course of its business. Excess coverage with an insurance company is in place to cover losses above self-insured retention levels.

Assets in the Trust are to provide for payment of professional and general liability claims and expenses. Potential losses from asserted and unasserted claims are accrued based on estimates that incorporate the Institute's past experience, as well as other considerations, including the nature of each claim or incident, applicable insurance coverage and relevant trend factors.

An accrued liability related to asserted and unasserted self-insured general and professional liability claims of $1,594 and $1,431 has been recorded at June 30, 2018 and 2017, respectively, and is included in Accrued expenses. Investments in the Trust have a market value of $4,212 and $3,959 at June 30, 2018 and 2017, respectively and are reported in Investments limited as to use on the Consolidated Balance Sheets.

**Workers' Compensation, Unemployment and Health Benefits**

The Institute self-insures its workers' compensation, unemployment and employee health and dental benefits. Losses from claims identified by the Institute, as well as provisions for estimated losses for incurred but not reported incidents, are accrued based on estimates that incorporate the past experience of the Institute, as well as other considerations, including the nature of the claims or incidents and relevant trend factors. An accrued liability of $2,756 and $2,686 has been recorded at June 30, 2018 and 2017, respectively for these self-insured plans and is included in accrued expenses on the Consolidated Balance Sheets.

### 18. COMMITMENTS AND CONTINGENCIES

**Litigation**

The Institute is involved in claims and litigation on professional liability and personnel matters that arise in the ordinary course of its business. This litigation is not expected to result in losses that exceed insurance limits or have a materially adverse effect on the Institute's financial position.

There have been claims filed against the Hugo W. Moser Research Institute at Kennedy Krieger, Inc. arising out of two Federally-funded research studies performed in the early 1990s. The Institute has insurance believed adequate to cover any compensatory damages awarded for these claims. The Institute has been successful in defending its position on these cases and do not anticipate any material exposure going forward.

**Rental Lease Commitments**

Through the creation of MSP, all property and major equipment is leased/subleased to each operating entity. These transactions are eliminated through the consolidating of the Institute's financial statements.

**(in thousands)**

Commitments for leases that do not meet the criteria for capitalization are classified as operating leases with related rentals charged to operations as incurred. The following is a schedule by year of future minimum lease payments under operating leases as of June 30, 2018, that have initial or remaining lease terms in excess of one year.

| | |
|---|---|
| 2019 | $ 2,318 |
| 2020 | 2,120 |
| 2021 | 1,651 |
| 2022 | 1,619 |
| 2023 | 969 |
| Thereafter | 200 |
| | $ 8,877 |

Rent expense on external lease commitments for the years ended June 30, 2018 and 2017 was $2,800 and $2,369 respectively.

**Charitable Gift Annuities**
The Institute has received charitable gift annuities from donors from which the Institute has guaranteed payments to the donor on a quarterly basis until the donor's death.

The Institute has recorded gift annuities, net of reserves, consistent with the rates adopted by the American Council on Gift Annuities at the time of issuance of the gift annuity. Assets maintained on outstanding annuity agreements exceed the amount of the reserve. Gift annuities with a market value of $689 and $747 and reserves for annuity payments of $423 and $498 to make gift annuity payments have been recorded in 2018 and 2017, respectively, and are included in Investments limited as to use on the Consolidated Balance Sheets.

**Epic Outpatient Clinical System**
The Institute entered into agreements with Epic to license and implement a new clinical system for use in outpatient services. As part of the agreements, the Institute committed to a 4 year payment plan which included both the license fees and implementation costs. Through the end of fiscal year 2018, $1.0 million has been paid under this commitment. The future year commitments are as follows:

| | |
|---|---|
| 2019 | $ 1,992 |
| 2020 | 1,992 |
| 2021 | 1,992 |
| 2022 | 992 |
| | $ 6,968 |

**(in thousands)**

## 19. FUNCTIONAL EXPENSES

The Institute provides specialty pediatric health care services, administers professional training programs, conducts laboratory and clinical research, operates special education school programs, administers community-based services, conducts fundraising activities and operates ancillary ventures. Expenses related to providing these services are as follows:

| | 2018 | 2017 |
|---|---|---|
| Special pediatric healthcare services | $ 130,490 | $ 123,877 |
| Research | 23,194 | 27,168 |
| Education/community services | 43,360 | 41,915 |
| Fundraising activities | 3,200 | 3,029 |
| Operation of facilities | 26,099 | 26,156 |
| General and administrative | 29,567 | 26,654 |
| | $ 255,910 | $ 248,799 |

## 20. SUBSEQUENT EVENTS

Kennedy Krieger Institute has evaluated subsequent events through September 27, 2018 which is the date the Financial Statements were issued. There have been no events subsequent to that date that needed to be disclosed.

## Report of Independent Auditors

To the Board of Directors of
Kennedy Krieger Institute, Inc. and Affiliates

We have audited the consolidated financial statements of Kennedy Krieger Institute, Inc. and Affiliates, as of June 30, 2018 and for the year then ended and our report thereon appears on pages 1-2 of this document. That audit was conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The consolidating information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The consolidating information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves and other additional procedures, in accordance with auditing standards generally accepted in the United States of America. In our opinion, the consolidating information is fairly stated, in all material respects, in relation to the consolidated financial statements taken as a whole. The consolidating information is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position, results of operations, changes in net assets and cash flows of the individual companies and is not a required part of the consolidated financial statements. Accordingly, we do not express an opinion on the financial position, results of operations, changes in net assets and cash flows of the individual companies.

PricewaterhouseCoopers LLP

Baltimore, Maryland
September 27, 2018

*PricewaterhouseCoopers LLP, 100 East Pratt Street, Suite 2600, Baltimore, MD 21202 T: (410) 783-7600, F: (410) 783-7680,* www.pwc.com/us

## SUPPLEMENTAL CONSOLIDATING FINANCIAL STATEMENTS

# Kennedy Krieger Institute, Inc. and Affiliates
## Consolidating Balance Sheet Information
## Year Ended June 30, 2018

| | Kennedy Krieger Children's Hospital, Inc | Hugo W. Moser Research Institute at Kennedy Krieger, Inc. | Kennedy Krieger Education & Community Services, Inc. | Kennedy Krieger Foundation, Inc. | PACT: Helping Children with Special Needs, Inc. | Madison Street Properties, Inc. | Consolidating Eliminations | Consolidated Totals |
|---|---|---|---|---|---|---|---|---|
| Assets | | | | | | | | |
| Current assets: | | | | | | | | |
| Cash and cash equivalents | $ 3,720,708 | ` | | $ 11,407,552 | $ 279,202 | | | $ 15,407,462 |
| Patient receivables, net | 22,106,605 | | | | 206,887 | | | 22,313,492 |
| Grant and contract receivable | 163,853 | $ 3,451,657 | $ 979,859 | | 452,309 | | | 5,047,678 |
| Tuition receivable | | | 6,093,959 | | | | | 6,093,959 |
| Pledges receivable | | | | 9,032,507 | 5,098 | | | 9,037,605 |
| Investments limited as to use | | | | 7,132,511 | | $ 543,284 | | 7,675,795 |
| Due from affiliates | 93,778,106 | | 6,549,103 | | 75,621 | | $ (100,402,830) | - |
| Prepaid expenses and other | 1,547,175 | 629,873 | 185,000 | 4,149 | 1,697 | | (185,000) | 2,182,894 |
| Total Current Assets | 121,316,447 | 4,081,530 | 13,807,921 | 27,576,719 | 1,020,814 | 543,284 | (100,587,830) | 67,758,885 |
| Non-current assets: | | | | | | | | |
| Property and equipment, net | | | | | | 145,233,603 | | 145,233,603 |
| Investments: | | | | | | | | |
| Board designated endowment | | | | 55,559,870 | 355,026 | | | 55,914,896 |
| Investments limted as to use | 6,160,123 | | | 1,605,298 | | | | 7,765,421 |
| Pledges receivable, net | | | | 3,763,220 | | | | 3,763,220 |
| Total non-current assets | 6,160,123 | - | - | 60,928,388 | 355,026 | 145,233,603 | - | 212,677,140 |
| Total assets | $ 127,476,570 | $ 4,081,530 | $ 13,807,921 | $ 88,505,107 | $ 1,375,840 | $ 145,776,887 | $ (100,587,830) | $ 280,436,025 |
| Liabilities and net assets | | | | | | | | |
| Current liabilities: | | | | | | | | |
| Accounts payable and accrued expenses | 30,386,498 | 1,227,982 | 103,547 | 333,000 | 72,786 | 1,983,022 | | 34,106,835 |
| Due to affiliates | | 15,192,083 | | 1,087,649 | | 84,123,098 | (100,402,830) | - |
| Deferred grant revenue | 8,455 | 1,824,087 | 127,032 | | 250,646 | | | 2,210,220 |
| Line of credit | | | | | | | | - |
| Current portion of tax-exempt bonds | | | | | | 3,124,644 | | 3,124,644 |
| Total Current Liabilities | 30,394,953 | 18,244,152 | 230,579 | 1,420,649 | 323,432 | 89,230,764 | (100,402,830) | 39,441,699 |
| Non-current Liabilities: | | | | | | | | |
| Tax-exempt bonds | | | | | | 80,402,971 | | 80,402,971 |
| Accrued pension | 14,740,137 | | | | | | | 14,740,137 |
| Interest rate swap | | | | | | 6,319,841 | | 6,319,841 |
| Other long-term liabilities | 2,274,050 | | | | | 1,650,000 | | 3,924,050 |
| Total long-term liabilities | 17,014,187 | - | - | - | - | 88,372,812 | - | 105,386,999 |
| Total liabilities | 47,409,140 | 18,244,152 | 230,579 | 1,420,649 | 323,432 | 177,603,576 | (100,402,830) | 144,828,698 |
| Net assets: | | | | | | | | |
| Unrestricted | 76,521,572 | (19,720,378) | 12,832,898 | 61,751,104 | 409,405 | (31,826,689) | (185,000) | 99,782,912 |
| Temporarily restricted | 3,545,858 | 5,557,756 | 744,444 | 24,375,132 | 643,003 | | | 34,866,193 |
| Permanently restricted | | | | 958,222 | | | | 958,222 |
| Total net assets | 80,067,430 | (14,162,622) | 13,577,342 | 87,084,458 | 1,052,408 | (31,826,689) | (185,000) | 135,607,327 |
| Total liabilities and net assets | $ 127,476,570 | $ 4,081,530 | $ 13,807,921 | $ 88,505,107 | $ 1,375,840 | $ 145,776,887 | $ (100,587,830) | $ 280,436,025 |

# Kennedy Krieger Institute, Inc. and Affiliates
## Consolidating Statement of Operations
## Year Ended June 30, 2018

| | Kennedy Krieger Children's Hospital, Inc | Hugo W. Moser Research Inst at Kennedy Krieger, Inc. | Kennedy Krieger Education & Community Services, Inc. | Kennedy Krieger Foundation Inc. | PACT: Helping Children with Special Needs, Inc. | Madison Street Properties Inc. | Consolidating Eliminations | Consolidated Totals |
|---|---|---|---|---|---|---|---|---|
| Operating revenues: | | | | | | | | |
| Patient service revenue, net | $ 160,485,182 | $ 4,474,019 | $ 2,450,564 | | $ 279,656 | | $ (1,525,829) | $ 166,163,592 |
| Tuition revenue | 53,432 | | 48,232,031 | | 658,954 | | | 48,944,417 |
| Grant and contract revenue | 1,642,078 | 26,129,518 | 4,540,610 | | 1,636,816 | | | 33,949,022 |
| Net assets released for operating activities | 1,607,443 | 647,655 | 924,306 | $ 558,014 | 81,706 | | | 3,819,124 |
| Investment earnings used for operating activities | | | | 2,021,736 | | | | 2,021,736 |
| Unrestricted contributions from | | | | | | | | - |
| fundraising activities, net | | | | 1,623,339 | | | | 1,623,339 |
| Other operating revenues | 861,150 | | 7,988 | 38,770 | 360,903 | $ 30,432,608 | (30,127,279) | 1,574,140 |
| Total operating revenues | 164,649,285 | 31,251,192 | 56,155,499 | 4,241,859 | 3,018,035 | 30,432,608 | (31,653,108) | 258,095,370 |
| Operating expenses: | | | | | | | | |
| Salaries, wages and benefits | 118,893,972 | 19,140,644 | 42,584,769 | 1,312,494 | 2,539,030 | 7,001,978 | | 191,472,887 |
| Supplies, purchased services and other | 24,641,223 | 10,306,091 | 6,026,807 | 901,054 | 332,114 | 9,241,234 | (2,092,122) | 49,356,401 |
| Space costs, net | 16,683,371 | 5,640,734 | 6,563,531 | 241,545 | 138,026 | 293,779 | (29,560,986) | - |
| Depreciation | | | | | | 9,213,863 | | 9,213,863 |
| Rent | | | | | | 2,799,843 | | 2,799,843 |
| Interest | | | | | | 1,881,911 | | 1,881,911 |
| Total operating expenses | 160,218,566 | 35,087,469 | 55,175,107 | 2,455,093 | 3,009,170 | 30,432,608 | (31,653,108) | 254,724,905 |
| Operating revenues over (under) expenses | 4,430,719 | (3,836,277) | 980,392 | 1,786,766 | 8,865 | - | - | 3,370,465 |
| Non-operating activity: | | | | | | | | |
| Investment income and realized gains (losses), net | 156,699 | | | 187,604 | | | | 344,303 |
| Change in unrealized gains on investments, net | 158,457 | | | 2,484,161 | 29,547 | 123,682 | | 2,795,847 |
| Realized and unrealized (loss) on interest rate swap | | | | | | 1,270,500 | | 1,270,500 |
| Loss on early extinguishment of debt | | | | | | | | - |
| Restricted fundraising expenses | | | | (1,184,913) | | | | (1,184,913) |
| Net non-operating activity | 315,156 | - | - | 1,486,852 | 29,547 | 1,394,182 | - | 3,225,737 |
| Excess of revenues over (under) expenses | $ 4,745,875 | $ (3,836,277) | $ 980,392 | $ 3,273,618 | $ 38,412 | $ 1,394,182 | $ - | $ 6,596,202 |

# Kennedy Krieger Institute, Inc. and Affiliates
# Consolidating Statement of Changes in Net Assets
# Year Ended June 30, 2018

| | Kennedy Krieger Children's Hospital, Inc | Hugo W. Moser Research Institue at Kennedy Krieger, Inc. | Kennedy Krieger Education & Community Services, Inc. | Kennedy Krieger Foundation Inc. | PACT: Helping Children with Special Needs, Inc. | Madison Street Properties Inc. | Consolidating Eliminations | Consolidated Totals |
|---|---|---|---|---|---|---|---|---|
| Unrestricted net assets: | | | | | | | | |
| Excess of revenue over (under) expenses | $ 4,745,875 | $ (3,836,277) | $ 980,392 | $ 3,273,608 | $ 38,418 | $ 1,394,182 | | $ 6,596,198 |
| Net assets released from restrictions used for property and equipment | | | | | | 5,005,174 | | 5,005,174 |
| Change in funded status of defined benefit plan | 1,926,924 | | | | | | | 1,926,924 |
| Increase (decrease) in unrestricted net assets | 6,672,799 | (3,836,277) | 980,392 | 3,273,608 | 38,418 | 6,399,356 | | 13,528,296 |
| Unrestricted net assets, beginning of year | 69,848,774 | (13,884,100) | 11,852,505 | 56,477,494 | 370,990 | (38,226,048) | $ (185,000) | 86,254,615 |
| Unrestricted net assets, end of year | $ 76,521,573 | $ (17,720,377) | $ 12,832,897 | $59,751,102 | $ 409,408 | $ (31,826,692) | $ (185,000) | $ 99,782,911 |
| Temporarily restricted net assets: | | | | | | | | |
| Contributions from fundraising activities | 1,557,681 | 1,468,724 | 916,042 | 2,413,038 | 265,075 | | | 6,620,560 |
| Net assets released from restrictions used for operating activities | (1,607,443) | (647,655) | (924,306) | (558,014) | (81,706) | | | (3,819,124) |
| Net assets released from restrictions used for property and equipment | | (250,358) | | (4,754,816) | | | | (5,005,174) |
| Increase (decrease) in temporarily restricted net assets | (49,762) | 570,711 | (8,264) | (2,899,792) | 183,369 | | | (2,203,738) |
| Temporarily restricted net assets, beg. of year | 3,595,620 | 4,987,045 | 752,708 | 27,274,924 | 459,634 | | | 37,069,931 |
| Temporarily restricted net assets, end of year | $ 3,545,858 | $ 5,557,756 | $ 744,444 | $24,375,132 | $ 643,003 | $ - | $ - | $ 34,866,193 |
| Permanently restricted net assets: | | | | | | | | |
| Contributions received | | | | | | | | |
| Increase in permanently restricted net assets | | | | | | | | |
| Permanently restricted net assets, beg.of year | | | | 958,222 | | | | 958,222 |
| Permanently restricted net assets, end of year | $ - | $ - | $ - | $ 958,222 | $ - | $ - | $ - | $ 958,222 |
| Increase(decrease) in net assets | 6,623,037 | (3,265,566) | 972,128 | 373,816 | 221,787 | 6,399,356 | | 11,324,558 |
| Net assets, beginning of year | 73,444,394 | (8,897,055) | 12,605,213 | 84,710,640 | 830,624 | (38,226,048) | (185,000) | 124,282,768 |
| Net assets, end of year | $ 80,067,431 | $ (12,162,621) | $ 13,577,341 | $85,084,456 | $ 1,052,411 | $ (31,826,692) | $ (185,000) | $ 135,607,326 |

## 1. Basis of Presentation and Accounting

The Supplementary Consolidating Financial Statements presented on pages 36-38 were derived from and relate directly to the underlying accounting and other records used to prepare the consolidated financial statements. The consolidating information is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial positions and changes in net assets of the individual companies within the Institute and are not a required part of the consolidated financial statements. The individual affiliates within the Institute as presented within the supplementary consolidating financial statements are disclosed within Note 1 to the consolidated financial statements.