



THE AMERICAN NATIONAL RED CROSS

Consolidated Financial Statements

June 30, 2017

(with summarized information for the year ended June 30, 2016)

(With Independent Auditors' Report Thereon)



KPMG LLP
1676 International Drive
McLean, VA 22102

Independent Auditors' Report

The Board of Governors
The American National Red Cross:

We have audited the accompanying consolidated financial statements of The American National Red Cross (the Organization), which comprise the consolidated statement of financial position as of June 30, 2017 and the related consolidated statements of activities, functional expenses and cash flows for the year then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the organization'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 organization's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of The American National Red Cross as of June 30, 2017, and the changes in their net assets, their functional expenses and their cash flows for the year then ended in accordance with U.S. generally accepted accounting principles.



Report on Summarized Comparative Information

We have previously audited The American National Red Cross 2016 consolidated financial statements, and we expressed an unmodified audit opinion on those audited consolidated financial statements in our report dated October 27, 2016. In our opinion, the summarized comparative information presented herein as of and for the year ended June 30, 2016 is consistent, in all material respects, with the audited consolidated financial statements from which it has been derived.

KPMG LLP

McLean, VA
October 6, 2017

THE AMERICAN NATIONAL RED CROSS

Consolidated Statement of Financial Position

June 30, 2017

(with comparative information as of June 30, 2016)

(In thousands)

Assets	2017	2016
Current assets:		
Cash and cash equivalents	\$ 122,115	\$ 83,344
Investments (Note 4)	291,923	475,624
Trade receivables, including grants, net of allowance for doubtful accounts of \$2,284 in 2017 and \$2,398 in 2016 (Note 11)	196,593	197,120
Contributions receivable (Note 2)	69,511	66,430
Inventories, net of allowance for obsolescence of \$154 in 2017 and \$833 in 2016	40,708	38,179
Other current assets	37,658	32,226
Total current assets	758,508	892,923
Investments (Note 4)	1,238,862	1,157,730
Contributions receivable (Note 2)	17,135	8,672
Land, buildings, and other property, net (Note 3)	844,567	879,168
Assets held for sale, net (Note 3)	26,078	50,662
Other assets (Note 9)	257,430	246,651
Total assets	3,142,580	3,235,806
Liabilities and Net Assets		
Current liabilities:		
Accounts payable and accrued expenses	237,508	251,737
Current portion of debt (Note 5)	138,745	30,715
Postretirement benefits (Note 10)	3,723	3,665
Other current liabilities (Note 9 and 11)	149,155	141,644
Total current liabilities	529,131	427,761
Debt (Note 5)	506,867	572,234
Pension and postretirement benefits (Note 10)	779,975	1,103,157
Other liabilities (Notes 5 and 9)	130,684	146,981
Total liabilities	1,946,657	2,250,133
Net assets (Notes 7 and 8):		
Unrestricted net assets (deficit):		
Unrestricted cash available for operations, net investment in land, buildings and other property, and other unrestricted net assets	1,102,256	1,300,424
Pension and postretirement benefits and other long term liabilities	(1,352,041)	(1,724,876)
Total Unrestricted net assets (deficit)	(249,785)	(424,452)
Temporarily restricted net assets	608,304	602,314
Permanently restricted net assets	837,404	807,811
Total net assets	1,195,923	985,673
Commitments and contingencies (Notes 4, 5, 6, 10, 11)		
Total liabilities and net assets	\$ 3,142,580	\$ 3,235,806

See accompanying notes to the consolidated financial statements.

THE AMERICAN NATIONAL RED CROSS

Consolidated Statement of Activities

Year ended June 30, 2017
(with summarized information for the year ended June 30, 2016)
(In thousands)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Totals	
				2017	2016
Operating revenues and gains:					
Contributions:					
Corporate, foundation and individual giving	\$ 170,415	\$ 252,254	\$ 47	\$ 422,716	\$ 378,436
United Way and other federated	10,401	45,054	-	55,455	65,860
Legacies and bequests	70,010	25,132	19,482	114,624	96,824
Services and materials	54,745	13,185	-	67,930	61,353
Products and services:					
Biomedical	1,712,031	-	-	1,712,031	1,746,336
Program materials	133,517	-	-	133,517	132,606
Contracts, including federal government	74,578	-	-	74,578	74,119
Investment income (Note 4)	2,231	37,727	-	39,958	85,341
Other revenues	93,380	-	-	93,380	19,263
Net assets released from restrictions	418,935	(418,935)	-	-	-
Total operating revenues and gains	2,740,243	(45,583)	19,529	2,714,189	2,660,138
Operating expenses:					
Program services:					
Services to the Armed Forces	69,335	-	-	69,335	65,231
Biomedical services	1,831,520	-	-	1,831,520	1,736,307
Community services	25,367	-	-	25,367	33,164
Domestic disaster services	372,139	-	-	372,139	332,740
Health and safety services	139,303	-	-	139,303	148,310
International relief and development services	99,760	-	-	99,760	119,709
Total program services	2,537,424	-	-	2,537,424	2,435,461
Supporting services:					
Fund raising	189,623	-	-	189,623	169,676
Management and general	119,736	-	-	119,736	116,402
Total supporting services	309,359	-	-	309,359	286,078
Total operating expenses	2,846,783	-	-	2,846,783	2,721,539
Change in net assets from operations	(106,540)	(45,583)	19,529	(132,594)	(61,401)
Nonoperating investment gains(losses) (Note 4)	20,604	51,573	10,064	82,241	(146,385)
Pension-related changes other than net periodic benefit cost (Note 10)	260,603	-	-	260,603	(400,351)
Change in net assets	174,667	5,990	29,593	210,250	(608,137)
Net assets, beginning of year	(424,452)	602,314	807,811	985,673	1,593,810
Net assets, end of year	\$ (249,785)	\$ 608,304	\$ 837,404	\$ 1,195,923	\$ 985,673

See accompanying notes to the consolidated financial statements.

THE AMERICAN NATIONAL RED CROSS

Statement of Functional Expenses

Year ended June 30, 2017
(with summarized information for the year ended June 30, 2016)
(In thousands)

	Program Services							Total Program Services
	Services to the Armed Forces	Biomedical Services	Community Services	Domestic Disaster Services	Health and Safety Services	International Relief & Development Services		
Salaries and wages	\$ 26,938	\$ 756,933	\$ 10,694	\$ 96,645	\$ 51,065	\$ 20,558	\$ 962,833	
Employee benefits	10,924	306,939	4,337	39,190	20,707	8,336	390,433	
Subtotal	37,862	1,063,872	15,031	135,835	71,772	28,894	1,353,266	
Travel and maintenance	2,460	27,539	179	26,918	5,307	3,678	66,081	
Equipment maintenance and rental	792	47,778	938	9,385	1,381	1,667	61,941	
Supplies and materials	1,287	401,604	1,135	6,495	9,589	903	421,013	
Contractual services	8,521	251,862	3,412	57,339	45,795	18,080	385,009	
Financial and material assistance	17,056	2,627	4,128	127,017	631	46,201	197,660	
Depreciation and amortization	1,357	36,238	544	9,150	4,828	337	52,454	
Total expenses	\$ 69,335	\$ 1,831,520	\$ 25,367	\$ 372,139	\$ 139,303	\$ 99,760	\$ 2,537,424	

	Supporting Services				
	Fund Raising	Management and General	Total Supporting Services	Total Expenses	
				2017	2016
Salaries and wages	\$ 79,894	\$ 48,935	\$ 128,829	\$ 1,091,662	\$ 1,117,797
Employee benefits	32,397	19,843	52,240	442,673	296,357
Subtotal	112,291	68,778	181,069	1,534,335	1,414,154
Travel and maintenance	4,720	3,041	7,761	73,842	65,462
Equipment maintenance and rental	2,252	2,489	4,741	66,682	75,224
Supplies and materials	2,631	828	3,459	424,472	415,785
Contractual services	62,146	38,676	100,822	485,831	477,247
Financial and material assistance	462	737	1,199	198,859	211,844
Depreciation and amortization	5,121	5,187	10,308	62,762	61,823
Total expenses	\$ 189,623	\$ 119,736	\$ 309,359	\$ 2,846,783	\$ 2,721,539

See accompanying notes to the consolidated financial statements.

THE AMERICAN NATIONAL RED CROSS

Consolidated Statement of Cash Flows

Year ended June 30, 2017
(with comparative information for the year ended June 30, 2016)
(In thousands)

	2017	2016
Cash flows from operating activities:		
Change in net assets	\$ 210,250	\$ (608,137)
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Depreciation and amortization	62,762	61,823
Provision for doubtful accounts receivable	(214)	(897)
Provision for obsolete inventory	(679)	(6,465)
Net (gains)/losses on sales of property	(59,825)	3,191
Net investment and derivative (gains)/losses	(65,242)	94,549
Pension and postretirement related changes other than net periodic benefit costs	(260,603)	400,351
Permanently restricted contributions	(27,392)	(25,450)
Changes in operating assets and liabilities:		
Receivables	(10,803)	5,018
Inventories	(1,850)	39,841
Other assets	(16,211)	(5,858)
Accounts payable and accrued expenses	(14,229)	(9,240)
Other liabilities	(11,539)	(11,556)
Pension and postretirement benefits	(62,521)	20,157
Net cash used in operating activities	(258,096)	(42,673)
Cash flows from investing activities:		
Purchases of property	(48,394)	(60,311)
Proceeds from sales of property	4,850	1,322
Proceeds from properties held for sale	99,792	26,276
Purchases of investments	(166,377)	(454,668)
Proceeds from sales of investments	336,941	510,658
Net cash provided by investing activities	226,812	23,277
Cash flows from financing activities:		
Permanently restricted contributions	27,392	25,450
Proceeds from borrowing	100,000	-
Repayments of debt	(57,337)	(42,032)
Net cash provided by financing activities	70,055	(16,582)
Net increase/(decrease) in cash and cash equivalents	38,771	(35,978)
Cash and cash equivalents, beginning of year	83,344	119,322
Cash and cash equivalents, end of year	\$ 122,115	\$ 83,344
Supplemental disclosures of cash flow information:		
Cash paid during the year for interest	\$ 23,482	\$ 24,975

See accompanying notes to the consolidated financial statements.

THE AMERICAN NATIONAL RED CROSS

Notes to Consolidated Financial Statements

June 30, 2017

(with summarized information for the year ended June 30, 2016)

(1) Summary of Significant Accounting Policies

Organization and Basis of Presentation: The American National Red Cross (the Organization) was established by an Act of the United States Congress on January 5, 1905 for the primary purposes of furnishing volunteer aid to the sick and wounded of the Armed Forces in time of war and to carry on a system of national and international relief in time of peace to mitigate the suffering caused by fire, famine, floods and other great natural calamities. The mission of the Organization has expanded since that time to help people prevent, prepare for, and respond to emergencies.

The accompanying consolidated financial statements present the consolidated financial position and changes in net assets, functional expenses and cash flows of the Organization. The Organization has national and international programs that are conducted by its headquarters, biomedical services, and chartered local chapters. Also included in the consolidated financial statements are the net assets and operations of Boardman Indemnity Ltd., a 100% owned captive insurance subsidiary, ARC Receivables Company, LLC, a wholly owned bankruptcy-remote special purpose entity, and Delta Blood Bank, LLC, a wholly owned blood bank. All significant intra-organizational accounts and transactions have been eliminated.

Program activities include services to the Armed Forces, biomedical services, community services, disaster services, health and safety services, and international relief and development services. Biomedical services include activities associated with the collection, processing, testing, and distribution of whole blood and components at 36 local blood services region operations, three national testing laboratories, a biomedical research facility, and related national support functions.

Net assets, revenues, gains, and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, the net assets of the Organization and changes therein are classified and reported as follows:

Unrestricted net assets – Net assets that are not subject to any donor-imposed stipulations.

Temporarily restricted net assets – Net assets subject to donor-imposed restrictions on their use that may be met either by actions of the Organization or the passage of time.

Permanently restricted net assets – Net assets subject to donor-imposed or other legal restrictions requiring that the principal be maintained permanently by the Organization. Generally, the donors permit the Organization to use all or part of the income earned for either general or donor-specified purposes.

THE AMERICAN NATIONAL RED CROSS

Notes to Consolidated Financial Statements

June 30, 2017

(with summarized information for the year ended June 30, 2016)

The consolidated financial statements are presented with certain prior year summarized comparative information. Such information does not include sufficient detail to constitute a presentation in conformity with U.S. generally accepted accounting principles. Accordingly, such information should be read in conjunction with the Organization's consolidated financial statements for the year ended June 30, 2016 from which the summarized information was derived.

(a) Use of Estimates

The preparation of the consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities in the financial statements. Estimates and assumptions may also affect disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses. Actual results could differ from management's estimates.

(b) Cash Equivalents

The Organization considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents. Cash equivalents consist of money market mutual funds and overnight investments of approximately \$114 million and \$64 million as of June 30, 2017 and 2016, respectively.

(c) Investments

Investments are reported at fair value except for certain alternative investment funds that, as a practical expedient, are reported at estimated fair value utilizing net asset values. Net asset value, in some instances may not equal the fair value. The Organization does not intend to sell any of the funds at an amount different from net asset value per share at June 30, 2017. The Organization reviews and evaluates the net asset values provided by the general partners and fund managers and agrees with the valuation methods and assumptions used in determining net asset values of these funds.

Investment income classified as operating revenue consists of interest and dividend income on investments and any gains approved for use in operations (note 4). All other realized and unrealized gains or losses are classified as nonoperating activities and are available to support operations in future years and to offset potential market declines.

Investments classified as current are available for operations in the next fiscal year.

(d) Derivative Financial Instruments

The Organization makes use of derivative financial instruments in order to create or mitigate certain risks. Derivative financial instruments are recorded at fair value (note 4). Derivatives in an asset and liability position are offset against each other and reported net in investments in the statement of financial position.

(e) Endowment Fund

The Organization has maintained a national endowment fund since 1905. From 1910 until June 30, 2015, any gift to the American Red Cross National Headquarters from a will, trust or similar instrument

THE AMERICAN NATIONAL RED CROSS

Notes to Consolidated Financial Statements

June 30, 2017

(with summarized information for the year ended June 30, 2016)

that did not direct the use of the funds was deposited into the Endowment Fund, recorded as permanently restricted to be kept and invested in perpetuity and, accordingly, reported as permanently restricted net assets. In fiscal year 2015, the Organization adopted a new policy that gifts to the American Red Cross National Headquarters from a will, trust or similar instrument dated on or after July 1, 2015 without a direction to the application or purpose of the funds shall be allocated at the discretion of senior management to where the need is greatest. Such amounts will be reported as increases to unrestricted net assets. All gifts to the American Red Cross National Headquarters that are designated to be permanently restricted shall continue to be deposited into the Endowment Fund regardless of the date of the gift instrument.

(f) Inventories

Inventories of supplies purchased for use in program and supporting services are valued using the average cost method. Whole blood and its components are valued at the lower of average cost or market.

(g) Land, Buildings, and Other Property

Purchases of land, buildings, and other property having a unit cost per established guidelines and a useful life of three or more years are capitalized at cost. Donated assets are capitalized at the estimated fair value at date of receipt. Interest expense incurred during a period of construction, less related interest income earned on proceeds of tax-exempt borrowings, is capitalized.

Property under capital leases is amortized over the lease term. Any gain or loss on the sale of land, buildings and other property is reported as other revenues on the consolidated statement of activities.

Application development costs incurred to develop internal-use software are capitalized and amortized over the expected useful life of the software application. Activities that are considered application development include design of software configuration and interfaces, coding, installation of hardware, and testing. All other expenses incurred to develop internal-use software are expensed as incurred.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets as follows:

<u>Class of property</u>	<u>Useful life in years</u>
Buildings	45
Building improvements	10
Equipment and software	3–15

(h) Long-Lived Assets

Long-lived assets, such as land, building and other property, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If circumstances require a long-lived asset be tested for possible impairment, the

THE AMERICAN NATIONAL RED CROSS

Notes to Consolidated Financial Statements

June 30, 2017

(with summarized information for the year ended June 30, 2016)

Organization first compares undiscounted cash flows expected to be generated by an asset to the carrying value of the asset. If the carrying value of the long-lived asset is not recoverable on an undiscounted cash flow basis, an impairment loss is recognized to the extent that the carrying value exceeds its fair value. Fair value is determined through various valuation techniques including discounted cash flow models, quoted market values and third-party independent appraisals, as considered necessary.

(i) Property and Casualty Insurance

The Organization maintains various insurance policies under which it assumes a portion of each insured loss. Assumed losses are retained by the Organization through its wholly owned insurance subsidiary, Boardman Indemnity, Ltd. (Boardman). The Organization also purchases insurance to supplement the coverage by Boardman. The liabilities for outstanding losses and incurred but not reported claims have been determined based on actuarial studies and are reported as other liabilities in the consolidated statement of financial position, and were approximately \$83 million and \$91 million as of June 30, 2017 and 2016, respectively.

(j) Revenue Recognition

Contributions, which include unconditional promises to give (pledges), are recognized as revenues in the period received or promised. Contributions receivable due beyond one year are stated at net present value of the estimated cash flows using a risk-adjusted rate. Conditional contributions are recorded when the conditions have been substantially met. Contributions are considered to be unrestricted unless specifically restricted by the donor for time or purpose.

The Organization reports contributions in the temporarily or permanently restricted net asset class if they are received with donor stipulations as to their use and/or time. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are released and reclassified to unrestricted net assets in the consolidated statement of activities.

Donor-restricted contributions are initially reported in the temporarily restricted net asset class, even if it is anticipated such restrictions will be met in the current reporting period.

Products and services revenue, which arises principally from sales of whole blood and components and health and safety course fees, is generally recognized upon shipment of the product or delivery of the services to the customer.

Revenues from grants and contracts, including those from federal agencies, are generally reported as unrestricted contract revenue and are recognized as qualifying expenses are incurred under the agreement.

Gains and losses on investments and other assets and liabilities are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor stipulation or by law.

THE AMERICAN NATIONAL RED CROSS

Notes to Consolidated Financial Statements

June 30, 2017

(with summarized information for the year ended June 30, 2016)

(k) Contributed Services and Materials

Contributed services reflect the important impact volunteers have in delivering the Organization's mission. Contributed services are reported at fair value in the financial statements for voluntary donations of services when those services (1) create or enhance nonfinancial assets or (2) require specialized skills provided by individuals possessing those skills and are services which would be typically purchased if not provided by donation.

The Organization engages more than 283,000 volunteers. A small percentage of these volunteers meet the above criteria and are reported in contributed services. Contributed services for the year ended June 30, 2017 includes the services of approximately 13,100 volunteers. The Organization recorded contributed services revenue and related expense of approximately \$40 million and \$36 million, for the year ended June 30, 2017 and 2016, respectively. Of the \$40 million and \$36 million recorded in 2017 and 2016, respectively, \$31 million related to volunteer efforts in support of disaster services and services to the Armed Forces.

Contributed materials are recorded at their fair value at the date of the gift. Gifts of long-lived assets are recorded as restricted support. This restriction is released ratably over the useful life of the asset.

(l) Income Taxes

The American National Red Cross is a not-for-profit organization incorporated by the U.S. Congress through the issuance of a federal charter. The Organization is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code, except on net income derived from unrelated business activities. At June 30, 2017 and 2016, the Organization has determined that no income taxes are due for such activities. Accordingly, no provision for income taxes has been recorded in the accompanying financial statements. Management annually reviews its tax positions and has determined that there are no material uncertain tax positions that require recognition in the consolidated financial statements.

(m) Accounts Receivable Securitization

The Organization has an accounts receivable securitization program that is accounted under Accounting Standards Update (ASU) No. 2009-16, *Transfers and Servicing (Topic 860): Accounting for Transfers of Financial Assets* (note 11).

(n) Adoption of Recently Issued Accounting Pronouncements

In fiscal year 2017, the Organization early adopted the provision related to the fair value disclosure exemption provided to nonpublic business entities of ASU 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities*. For nonpublic business entities, the ASU eliminates the requirement under ASC 825, *Financial Instruments*, to disclose the fair values of financial assets and financial liabilities measured in the financial statements at amortized cost.

THE AMERICAN NATIONAL RED CROSS

Notes to Consolidated Financial Statements

June 30, 2017

(with summarized information for the year ended June 30, 2016)

(2) Contributions Receivable

The Organization anticipates collection of outstanding contributions receivable as follows at June 30, 2017 and 2016 (in thousands):

	<u>2017</u>	<u>2016</u>
Amounts receivable within one year	\$ 72,246	69,264
Amounts receivable in 1 to 5 years (net of discount of \$1,073 and \$771 for 2017 and 2016, respectively)	<u>17,135</u>	<u>8,672</u>
Total contributions receivable before allowance for uncollectible amounts	89,381	77,936
Less allowance for uncollectible amounts	<u>(2,735)</u>	<u>(2,834)</u>
Contributions receivable, net	86,646	75,102
Less current portion	<u>69,511</u>	<u>66,430</u>
Contributions receivable, net, noncurrent	\$ <u><u>17,135</u></u>	\$ <u><u>8,672</u></u>

Amounts presented above have been discounted to present value using various discount rates ranging between 0.41% and 2.6%.

(3) Land, Buildings, and Other Property

The cost and accumulated depreciation of land, buildings, and other property were as follows at June 30, 2017 and 2016 (in thousands):

	<u>2017</u>	<u>2016</u>
Land	\$ 103,852	109,554
Buildings and improvements	1,065,217	1,070,812
Equipment and software	<u>555,603</u>	<u>562,645</u>
Total cost of assets placed in service	1,724,672	1,743,011
Less accumulated depreciation and amortization	(882,338)	(884,327)
Construction-in-progress	<u>2,233</u>	<u>20,484</u>
Land, buildings, and other property, net	\$ <u><u>844,567</u></u>	\$ <u><u>879,168</u></u>

THE AMERICAN NATIONAL RED CROSS

Notes to Consolidated Financial Statements

June 30, 2017

(with summarized information for the year ended June 30, 2016)

Assets held for sale were as follows at June 30, 2017 and 2016 (in thousands):

	<u>2017</u>	<u>2016</u>
Land	\$ 8,482	12,601
Buildings and improvements	<u>36,145</u>	<u>68,702</u>
Total cost of assets held for sale	44,627	81,303
Less accumulated depreciation and amortization	<u>(18,549)</u>	<u>(30,641)</u>
Assets held for sale, net	<u>\$ 26,078</u>	<u>50,662</u>

These assets have been segregated from land, buildings, and other property and presented as assets held for sale within the accompanying consolidated financial statements. The Organization identified these assets as not critical to supporting its primary mission as part of ongoing assessment procedures. The Organization then evaluated the identified assets using the criteria for classification as held for sale included in ASU 205 2014-08, Topic 360, *Property, Plant, and Equipment*. Certain assets or portions of assets identified were determined to meet the criteria and have been classified as such. The carrying value of these assets has been compared to the current appraised values less cost to sell and determined not to be impaired. During fiscal year ended June 30, 2017, the gain on the buildings and improvements assets held for sale was approximately \$63M, which is included in other revenue on consolidated statement of activities.

(4) Investments and Fair Value Measurements

The Organization applies the provisions of ASC 820, *Fair Value Measurements and Disclosures*, for fair value measurements of investments that are recognized and disclosed at fair value in the financial statements on a recurring basis. ASC 820 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. ASC 820 also establishes a fair value hierarchy that requires the Organization to maximize the use of observable inputs when measuring fair value. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Organization's market assumptions. The three levels of the fair value hierarchy are as follows:

- Level 1 – Quoted prices for identical assets or liabilities in active markets.
- Level 2 – Quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; inputs other than quoted prices that are observable for the asset or liability; or market – corroborated inputs.
- Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

In certain cases, the inputs to measure fair value may result in an asset or liability falling into more than one level of the fair value hierarchy. In such cases, the determination of the classification of an asset or liability within the fair value hierarchy is based on the least determinate input that is significant to the fair value measurement.

THE AMERICAN NATIONAL RED CROSS

Notes to Consolidated Financial Statements

June 30, 2017

(with summarized information for the year ended June 30, 2016)

For the years ended June 30, 2017 and 2016, there were no transfers between levels.

The Organization's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability.

The following table represents investments that are measured at fair value on a recurring basis at June 30, 2017 (in thousands):

	<u>June 30, 2017</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Measured at NAV(1)</u>
Fixed income commingled funds	\$ 190,970	—	190,970	—	—
Equity commingled funds	195,223	—	195,223	—	—
Hedge funds	435,784	—	—	87	435,697
Private equity and debt	182,409	—	—	4,160	178,249
Real estate and real assets	24,451	—	—	—	24,451
Derivative contracts	19,601	—	19,601	—	—
Cash and cash equivalents	<u>482,347</u>	<u>6,025</u>	<u>476,322</u>	<u>—</u>	<u>—</u>
Total investments	\$ <u>1,530,785</u>	<u>6,025</u>	<u>882,116</u>	<u>4,247</u>	<u>638,397</u>

The following table represents investments that are measured at fair value on a recurring basis at June 30, 2016 (in thousands):

	<u>June 30, 2016</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Measured at NAV(1)</u>
Fixed income commingled funds	\$ 191,619	—	191,619	—	—
Equity commingled funds	219,285	—	219,285	—	—
Hedge funds	409,365	—	—	104	409,261
Private equity and debt	191,503	—	—	4,918	186,585
Real estate and real assets	38,884	—	—	11,493	27,391
Derivative contracts	536	—	536	—	—
Cash and cash equivalents	<u>582,162</u>	<u>3,917</u>	<u>578,245</u>	<u>—</u>	<u>—</u>
Total investments	\$ <u>1,633,354</u>	<u>3,917</u>	<u>989,685</u>	<u>16,515</u>	<u>623,237</u>

(1) Certain investments are measured at fair value using NAV as a practical expedient and have not been classified in the fair value hierarchy. The NAV amounts have been presented to permit reconciliation of the fair value hierarchy to the amounts presented in the consolidated statement of financial position.

The Organization used quoted prices in principal active markets for identical assets as of the valuation date (Level 1) to value certain cash equivalents at June 30, 2017 and 2016.

For the valuation of certain cash equivalents, U.S. government and sovereign securities, and fixed income and equity commingled funds at June 30, 2017 and 2016, the Organization used significant other

THE AMERICAN NATIONAL RED CROSS

Notes to Consolidated Financial Statements

June 30, 2017

(with summarized information for the year ended June 30, 2016)

observable inputs, particularly dealer market prices for comparable investments as of the valuation date (Level 2). The Level 2 commingled funds have a readily determinable fair value.

For the most part, the valuation of hedge funds, private equity and debt funds, real estate and real assets funds, at June 30, 2017 and 2016, are reported at estimated fair value utilizing the net asset values provided by fund managers as a practical expedient. In a few instances, additional supplemental information provided by the fund manager has been utilized to evaluate fund values and level the investments. Reported fund values utilize significant unobservable inputs; management reviews and evaluates the values provided by fund managers and general partners and agrees with the valuation methods and assumptions used in determining the reported fair values of the alternative investments.

The following table presents the Organization's activity for investments measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the years ended June 30, 2017 and 2016 (in thousands):

	Balance as of June 30, 2016	Purchases	Settlements	Change in unrealized gains/ (losses)	Balance as of June 30, 2017
Hedge funds	\$ 104	—	(1,749)	1,732	87
Private equity and debt	4,918	—	(651)	(107)	4,160
Real estate and real assets	11,493	29	(18,543)	7,021	—
Total investments	\$ 16,515	29	(20,943)	8,646	4,247
	Balance as of June 30, 2015	Purchases	Settlements	Change in unrealized gains/ (losses)	Balance as of June 30, 2016
Hedge funds	\$ 91	872	(872)	13	104
Private equity and debt	4,847	18	(237)	290	4,918
Real estate and real assets	13,693	181	(1,530)	(851)	11,493
Total investments	\$ 18,631	1,071	(2,639)	(548)	16,515

THE AMERICAN NATIONAL RED CROSS

Notes to Consolidated Financial Statements

June 30, 2017

(with summarized information for the year ended June 30, 2016)

The following summarizes the nature and risk of those investments that are reported at estimated fair value utilizing net asset value as of June 30, 2017 (in thousands):

	<u>Fair value</u>	<u>Unfunded commitments</u>	<u>Redemption frequency</u>	<u>Redemption notice period</u>
Hedge funds (a) (c)	\$ 29,127	—	N/A	fully redeemed
Hedge funds (a)	406,570	—	monthly to bi-annually*	5–90 days
Private equity and debt (b)	178,249	95,221	None	—
Real estate and real assets (b)	<u>24,451</u>	<u>1,602</u>	None	—
Total	\$ <u>638,397</u>	<u>96,823</u>		

* bi-annually defined as every two years

- (a) Hedge Fund Investments. Hedge fund strategies include: relative value, event driven, and arbitrage strategies. Underlying hedge fund holdings can consist of the full spectrum of global equity and fixed income instruments. Positions may be long and short; leverage may also be used. Some funds may invest in side pockets, which are a separate share class and are not available for redemption until the investment is liquidated by the manager.
- (b) Non-Marketable Investment Strategies. Private equity and debt strategies include: leveraged buyout, growth equity, venture capital, and distressed debt. Real estate and real assets strategies include: natural resources (such as oil and gas or minerals and mining) and timber. Nonmarketable funds do not permit redemptions; capital is returned to investors at the discretion of the investment manager and in accordance with limited partnership terms. Interim distributions of interest and dividends can be made; however, capital and realized gains are generally distributed when underlying investments are liquidated. Funds are able to recall distributions. It is expected that the majority of the nonmarketable investments will be liquidated over the next ten years.
- (c) Represents funds redeemed and received since the June 30, 2017 reporting date. Also represents expected redemptions related to audit holdbacks, where funds retain a portion of requested redemptions until the fund's annual audit is complete in order to accommodate potential final NAV adjustments.

The Organization transacts in a variety of derivative instruments, including swaps and options, for investment and hedging purposes, in order to create or mitigate certain exposures. Each instrument's primary underlying exposure is equities, commodities, interest rates, or currencies. Such contracts involve, to varying degrees, risks of loss from the possible inability of counterparties to meet the terms of their contracts. In the case of over-the counter derivatives, collateralization and daily marks-to-market mitigate counterparty risk. The Organization also invests in highly liquid, exchange-traded contracts to achieve exposure to U.S. Treasury securities; these contracts are also marked-to-market daily, with daily exchanges of variation margin, but do not require collateralization per se. Foreign exchange derivatives can be used to facilitate trade purchases and sales as well as for hedging purposes.

THE AMERICAN NATIONAL RED CROSS

Notes to Consolidated Financial Statements

June 30, 2017

(with summarized information for the year ended June 30, 2016)

The following table lists the notional/contractual amount of derivatives by contract type included in investments at June 30, 2017 and 2016 (in thousands):

Derivative type	2017	2016
Equity contracts	\$ 158,748	180,000

The following table lists fair value of derivatives by contract type included in investments as of June 30, 2017 and 2016 (in thousands):

Derivative type	Derivative assets		Derivative liabilities	
	2017	2016	2017	2016
Equity contracts	\$ 19,601	536	—	—
Fair value of derivatives included in investments	\$ 19,601	536	—	—

The following table lists gains and losses on derivatives by contract type included in investment income as of June 30, 2017 and 2016 (in thousands):

Derivative type	Realized gains/(losses)		Change in unrealized gains/(losses)	
	2017	2016	2017	2016
Equity contracts	\$ 10,217	(4,616)	3,256	(1,414)
Total	\$ 10,217	(4,616)	3,256	(1,414)

For the valuation of the Organization's derivative contracts at June 30, 2017, the Organization used significant other observable inputs as of the valuation date (Level 2), including prices of instruments with similar maturities and characteristics, interest rate yield curves, measures of interest rate volatility and various market indices. The value was determined and adjusted to reflect nonperformance risk of both the counterparty and the Organization.

Investment securities are exposed to various risks, such as interest rate, market and credit. Due to the level of uncertainty related to changes in interest rates, market volatility and credit risks, it is at least reasonably possible that changes in these risks could materially affect the estimated fair value of investments reported in the consolidated statement of financial position as of June 30, 2017. However, the diversification of the Organization's invested assets among these various asset classes is management's strategy to mitigate the impact of any dramatic change on any one asset class.

THE AMERICAN NATIONAL RED CROSS

Notes to Consolidated Financial Statements

June 30, 2017

(with summarized information for the year ended June 30, 2016)

The following schedule summarizes the composition of investment return for the years ended June 30, 2017 and 2016 (in thousands):

	2017			2016	
	Unrestricted	Temporarily restricted	Permanently restricted	Total	Total
Dividends and interest	\$ 1,399	37,770	—	39,169	46,104
Net operating investment gains (losses)	832	(43)	—	789	39,237
Investment income available for operations	2,231	37,727	—	39,958	85,341
Net nonoperating investment gains (losses)	20,604	51,573	10,064	82,241	(146,385)
Total return on investments	\$ 22,835	89,300	10,064	122,199	(61,044)

(5) Debt

Debt consists of the following at June 30, 2017 and 2016 (in thousands):

	2017	2016
Fixed rate debt:		
Bearing interest rates ranging from 0% to 5.85%, due calendar year 2017 through 2044	\$ 473,217	483,707
Variable rate debt:		
Bearing interest rates ranging from 0.48% to 1.763%, due calendar year 2017 through 2034:		
Variable rate debt with demand repayment rights	57,395	89,242
Variable rate debt without demand repayment rights	115,000	30,000
Total bonds and notes payable	645,612	602,949
Less current portion	138,745	30,715
Debt, noncurrent portion	\$ 506,867	572,234

The Organization's debt is generally backed only by the full faith and credit of The American National Red Cross. Certain bonds are subject to redemption prior to the maturity at the option of the Organization. The repayment terms of the variable rate debt generally require monthly payments of interest and annual principal reduction. The registered owners of the bonds and notes with demand repayment rights may demand repurchase of the bonds and notes for an amount equal to the principal plus accrued interest. Letters of credit or standby credit facilities have been established with multiple banks in the aggregate

THE AMERICAN NATIONAL RED CROSS

Notes to Consolidated Financial Statements

June 30, 2017

(with summarized information for the year ended June 30, 2016)

amount of \$11 million and \$61 million for fiscal years 2017 and 2016, respectively, to provide liquidity in the event other funding is not available for repurchasing. As of June 30, 2017, the maturity dates for these liquidity facilities are in calendar year 2018. Approximately \$10 million of the debt with demand repayment rights bears interest at flexible rates with flexible rate periods of any duration up to 270 days. The remaining debt with demand repayment rights is remarketed on a weekly basis bearing interest rates that are reset weekly.

Certain of the Organization's debt agreements include covenants that require the Organization to maintain certain levels of financial ratios. The Organization was in compliance with its covenant requirements as of and for the year ended June 30, 2017.

Scheduled maturities and sinking fund requirements of the debt and credit agreements as of June 30, 2017 are as follows (in thousands):

2018	\$	138,745
2019		28,636
2020		28,736
2021		28,735
2022		33,835
Thereafter		<u>386,924</u>
	\$	<u>645,611</u>

Interest expense was approximately \$30 million and \$32 million for the years ended June 30, 2017 and 2016, respectively, which is included in contractual services on the statement of functional expenses.

(a) Bank Lines of Credit

The Organization maintained several committed and uncommitted lines of credit with various banks for its working capital requirements. As of June 30, 2017, there were \$100 million borrowings outstanding under lines of credit and there were no borrowings outstanding under lines of credit as of June 30, 2016. The Organization had unused lines of credit outstanding of approximately \$275 million at both June 30, 2017 and June 30, 2016. The amounts available to be borrowed on the lines of credit are subject to the limitations of the Organization's debt covenants.

(b) Interest Rate Swap Agreements

The Organization held variable rate debt of approximately \$172 million and \$119 million at June 30, 2017 and 2016, respectively. Interest rate swap agreements are used by the Organization to mitigate the risk of changes in interest rates associated with variable interest rate indebtedness. Under such arrangements, a portion of variable rate indebtedness is converted to fixed rates based on a notional principal amount. The interest rate swap agreements are derivative instruments that are recognized at fair value and recorded on the statement of financial position. At June 30, 2017, the aggregate notional principal amount under the interest rate swap agreements, with maturity dates ranging from calendar year 2017 through 2021, totaled \$62 million. At June 30, 2016, the aggregate notional principal amount under the interest rate swap agreements, with maturity dates ranging from calendar year 2016 through 2021, totaled \$80 million. The estimated fair value of the interest rate swap

THE AMERICAN NATIONAL RED CROSS

Notes to Consolidated Financial Statements

June 30, 2017

(with summarized information for the year ended June 30, 2016)

agreements was a liability of approximately \$2.9 million and \$5.7 million, respectively, and is included in other liabilities in the accompanying consolidated statements of financial position as of June 30, 2017 and 2016.

The change in fair value on these interest rate swap agreements was a gain of approximately \$2.8 million and \$0.1 million for the years ended June 30, 2017 and 2016, respectively, and is included in nonoperating gains in the consolidated statements of activities.

For the valuation of the interest rate swaps at June 30, 2017 and 2016, the Organization used significant other observable inputs as of the valuation date (Level 2), including prices of instruments with similar maturities and characteristics, interest rate yield curves and measures of interest rate volatility. The value was determined and adjusted to reflect nonperformance risk of both the counterparty and the Organization. See note 4 for definitions of Levels 1, 2 and 3.

(c) Letters of Credit

The Organization had unused letters of credit outstanding of approximately \$55 million at June 30, 2017 and 2016.

(6) Leases

The Organization leases certain buildings and equipment for use in its operations. The following summarizes minimum future rental payments under operating leases for the fiscal years ending June 30 (in thousands):

2018	\$	25,571
2019		17,623
2020		12,799
2021		10,621
2022		9,095
Thereafter		<u>51,710</u>
Total minimum lease payments	\$	<u><u>127,419</u></u>

Total rent expense was approximately \$45 million for both of the years ended June 30, 2017 and 2016, respectively, and is included in contractual services on the consolidated statement of functional expenses.

Future minimum rental payments to be received by the Organization for office space leased at the National Headquarters building as of June 30, 2017, are as follows (in thousands):

2018	\$	16,313
2019		16,450
2020		<u>16,590</u>
Total minimum lease payments to be received	\$	<u><u>49,353</u></u>

THE AMERICAN NATIONAL RED CROSS

Notes to Consolidated Financial Statements

June 30, 2017

(with summarized information for the year ended June 30, 2016)

Total rental income was approximately \$16 million for both of the years ended June 30, 2017, and 2016, respectively, and is included in other revenues on the consolidated statement of activities.

(7) Net Assets

Unrestricted net assets (deficit) are comprised of the following at June 30, 2017 and 2016 (in thousands):

	<u>2017</u>	<u>2016</u>
Unrestricted net assets (deficit)	\$ (249,785)	(424,452)
Add back (deduct) long term assets and liabilities:		
Pension and postretirement liabilities	783,698	1,106,822
Other long-term liabilities	568,343	618,054
Net investment in land, buildings and other property	<u>(775,359)</u>	<u>(778,007)</u>
Unrestricted net assets available for operations	\$ <u>326,897</u>	<u>522,417</u>

The organization monitors cash and investment reserve requirements across the entire enterprise to ensure service delivery can be performed. Management actively manages short- and long-term cash needs against all available liquidity from cash, investments and fair value of land, building, and equipment held for sale. As a result, it continues to have positive mission-related operating net assets, even though the Organization has pension-related and other long-term liabilities.

Temporarily restricted net assets are available for the following purposes or periods at June 30, 2017 and 2016 (in thousands):

	<u>2017</u>	<u>2016</u>
Disaster services	\$ 9,562	11,237
International relief and development services	118,325	153,073
Buildings and equipment	5,289	5,665
Endowment inflation adjustment reserve	218,235	207,264
Endowment assets available for future appropriation	170,180	129,858
Other specific purposes	11,926	20,526
Time restricted	<u>74,787</u>	<u>74,691</u>
Total temporarily restricted net assets	\$ <u>608,304</u>	<u>602,314</u>

Permanently restricted net assets at June 30, 2017 and 2016 consist primarily of endowed contributions, the income from which is available principally to fund general operations. Other permanently restricted net assets consist of beneficial interests in perpetual trusts and other split interest agreements (note 9).

THE AMERICAN NATIONAL RED CROSS

Notes to Consolidated Financial Statements

June 30, 2017

(with summarized information for the year ended June 30, 2016)

(8) Endowments

Effective January 23, 2008, the District of Columbia enacted the Uniform Prudent Management of Institutional Funds Act (UPMIFA), the provisions of which apply to endowment funds existing on or established after that date. Based on its interpretation of the provisions of UPMIFA, the Organization is required to act prudently when making decisions to spend or accumulate donor restricted endowment assets and in doing so to consider a number of factors including the duration and preservation of its donor restricted endowment funds. The Organization classifies as permanently restricted net assets the original value of gifts donated to be held in perpetuity. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Organization in a manner consistent with the standard of prudence prescribed by UPMIFA.

The Organization has adopted and the Governing Board has approved the Statement of Investment Policies and Objectives for the endowment fund. This policy has identified an appropriate risk posture for the fund, stated expectations and objectives for the fund, provides asset allocation guidelines and establishes criteria to monitor and evaluate the performance results of the fund's managers.

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 yield (interest and dividends).

The Organization makes distributions from income earned on the endowment fund for current operations using the total return method. In establishing this method, the Organization considered the long-term expected return on its funds. To the extent that distributions exceed net investment income, they are made from accumulated gains. The Board of Governors approves the spending rate, calculated as a percentage of the five-year calendar trailing average fair value of the endowment fund at the beginning of each fiscal year.

A spending rate of approximately 3.8% for both years 2017 and 2016 of the trailing five-year market value was applied to each unit of the endowment fund and resulted in total distributions of approximately \$37 million and \$36 million for the years ended June 30, 2017 and 2016, respectively. Approximately \$37 million and \$29 million of the amounts represent utilization of accumulated realized gains, for the years ended June 30, 2017 and 2016, respectively. A one-time annual spending rate of 15% of the trailing five-year market value has been approved for 2018.

Net asset classification by type of endowment as of June 30, 2017, is as follows (in thousands):

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$ —	388,415	659,345	1,047,760

THE AMERICAN NATIONAL RED CROSS

Notes to Consolidated Financial Statements

June 30, 2017

(with summarized information for the year ended June 30, 2016)

Changes in endowment net assets for the year ended June 30, 2017 (in thousands):

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Endowment net assets, beginning of year	\$ —	337,122	631,953	969,075
Investment return:				
Investment income	—	37,118	—	37,118
Net appreciation (net realized and unrealized gains/losses)	—	51,292	—	51,292
Total investment return	—	88,410	—	88,410
Contributions	—	—	27,392	27,392
Appropriation of endowment assets for expenditure	—	(37,117)	—	(37,117)
Endowment net assets, end of year	\$ <u>—</u>	<u>388,415</u>	<u>659,345</u>	<u>1,047,760</u>

(9) Split Interest Agreements

The Organization is a beneficiary of split interest agreements in the form of charitable gift annuities, perpetual trusts held by third parties, charitable remainder trusts and pooled income funds. The value of split interest agreements is measured as the Organization's share of fair value of the assets. Of the \$255 million and \$244 million in assets under these agreements as of June 30, 2017 and 2016, respectively, which are included in other assets on the consolidated statement of financial position, \$39 million and \$38 million, respectively, are charitable gift annuities and the remainder are assets for which the Organization is not the trustee. Liabilities associated with these agreements are \$29 million and \$27 million for the years ended June 30, 2017 and 2016, respectively, of which \$4 million and \$3 million is included in other current liabilities and \$25 million and \$24 million is included in other noncurrent liabilities on the consolidated statement of financial position, respectively.

(10) Benefit Plans

(a) *The Retirement System of the American National Red Cross and The American Red Cross Life and Health Benefit Plan*

Before July 1, 2009, employees of the American Red Cross, including employees of participating local chapters, were covered by the Retirement System of the American National Red Cross (the Plan) after one year of employment and completion of 1,000 hours of service during any consecutive 12 month period. Effective July 1, 2009, the Plan was closed to employees hired after June 30, 2009.

Subject to provisions contained in collective bargaining agreements where applicable, the Plan was frozen on December 31, 2012 (the freeze date). Employees who were participating in the Plan as of that date keep vested benefits earned, but stop earning additional pension benefits.

THE AMERICAN NATIONAL RED CROSS

Notes to Consolidated Financial Statements

June 30, 2017

(with summarized information for the year ended June 30, 2016)

Prior to the freeze date, the benefit formula was based on years of service and the employees' final average compensation. Final average compensation was calculated using the highest consecutive 48 months of the last 120 months of service before the earlier of retirement or the freeze date.

For funding purposes under the Plan, normal pension costs are determined by the projected unit credit method and are funded currently. The Plan provides a defined benefit pension, funded entirely by the employer. Prior to July 1, 2005, voluntary after-tax contributions could be made by active members to fund an optional annuity benefit. The Organization's funding policy is set to comply with the funding requirements established under the Pension Protection Act of 2006 and to meet the requirements of ERISA. During fiscal year 2017, the Organization contributed above the requirement amount for the Plan Year.

The Organization offered a lump sum special election window from September 1 through October 14, 2016. This option was made available to former employees who terminated their employment prior to July 1, 2016, were vested in the Plan and were not receiving monthly payments. The special election window provided the participants the option to cash out their retirement benefit or take an immediate annuity, which was actuarially reduced for early commencement. Special election window payments totaling approximately \$106 million were made upon submission of election forms starting in November 2016.

The American Red Cross purchased annuities, totaling approximately \$327.5 million effective June 18, 2017, for certain retirees. Those retirees, who as of July 1, 2016, have been receiving monthly pension payments of \$500 or less, are included in such annuity purchase.

The Organization also provides medical and dental benefits to eligible retirees and their eligible dependents under The American Red Cross Life and Health Benefits Plan. Generally, retirees and the Organization each pay a portion of the premium costs. The medical and dental plans pay a stated percentage of expenses reduced by deductibles and other coverages. The Organization has the right to modify cost-sharing provisions at any time. In addition, life insurance benefits of \$5,000 are provided with no contributions required from the retirees. The Organization's postretirement benefit plans are unfunded.

Effective January 1, 2009, the Organization eliminated plan coverage (retiree medical and life benefits) for all future retirees that did not meet certain eligibility conditions as of that date. In addition, the plan was amended to transition Medicare eligible retirees to a private fee-for-service plan and to change the premium supplement tables and indexing effective July 1, 2009. Beginning in calendar year 2011, most Medicare eligible retirees were offered a Healthcare Reimbursement Account (HRA) to utilize in purchasing individual coverage through an external exchange program through Aon Hewitt Retiree Exchange. Plans can vary from Medicare Advantage, Part D Prescription Drug and Medicare Supplement Plans.

THE AMERICAN NATIONAL RED CROSS

Notes to Consolidated Financial Statements

June 30, 2017

(with summarized information for the year ended June 30, 2016)

The following table presents the changes in benefit obligations, changes in Plan assets, and the composition of accrued benefit costs in the consolidated statements of financial position for the years ended June 30, 2017 and 2016 (in thousands):

	Pension benefits		Postretirement benefits	
	2017	2016	2017	2016
Changes in benefit obligations:				
Benefit obligations at beginning of year	\$ 3,013,553	2,706,324	67,473	66,166
Service cost	805	1,031	133	153
Interest cost	123,709	132,400	2,296	2,810
Plan amendment	—	—	—	(2,838)
Actuarial loss (gain)	(85,239)	294,970	(2,985)	4,781
Benefits paid	(119,482)	(121,172)	(3,319)	(3,599)
Settlements	(445,905)	—	—	—
Benefit obligations at end of year	2,487,441	3,013,553	63,598	67,473
Changes in plan assets:				
Fair value of plan assets at beginning of year	1,979,397	2,091,371	—	—
Actual return on plan assets	103,331	9,198	—	—
Employer contributions	250,000	—	—	—
Benefits paid	(119,482)	(121,172)	—	—
Settlements	(445,905)	—	—	—
Fair value of plan assets at end of year	1,767,341	1,979,397	—	—
Funded status-accrued benefit costs	\$ (720,100)	(1,034,156)	(63,598)	(67,473)

Pension-related changes other than net periodic benefit cost for 2017:

	Pension benefits	Postretirement benefits	Total
Prior service cost (benefit)	\$ —	(1,180)	(1,180)
Amortized net loss (gain)	199,265	(106)	199,159
Net actuarial (loss) gain	57,463	5,161	62,624
	\$ 256,728	3,875	260,603

THE AMERICAN NATIONAL RED CROSS

Notes to Consolidated Financial Statements

June 30, 2017

(with summarized information for the year ended June 30, 2016)

Pension-related changes other than net periodic benefit cost for 2016:

	Pension benefits	Postretirement benefits	Total
Prior service cost (benefit)	\$ —	(687)	(687)
Amortized net loss (gain)	18,261	(1,261)	17,000
Net actuarial (loss) gain	<u>(419,403)</u>	<u>640</u>	<u>(418,763)</u>
	<u>\$ (401,142)</u>	<u>(1,308)</u>	<u>(402,450)</u>

Items not yet recognized as a component of net periodic benefit cost for 2017:

	Pension benefits	Postretirement benefits	Total
Unrecognized prior service credit	\$ —	(1,408)	(1,408)
Unrecognized net actuarial loss (gains)	<u>945,918</u>	<u>(10,026)</u>	<u>935,892</u>
	<u>\$ 945,918</u>	<u>(11,434)</u>	<u>934,484</u>

Items not yet recognized as a component of net periodic benefit cost for 2016:

	Pension benefits	Postretirement benefits	Total
Unrecognized prior service credit	\$ —	(2,588)	(2,588)
Unrecognized net actuarial loss (gains)	<u>1,202,646</u>	<u>(7,146)</u>	<u>1,195,500</u>
	<u>\$ 1,202,646</u>	<u>(9,734)</u>	<u>1,192,912</u>

Estimated amounts to be amortized into net periodic benefit cost over the next fiscal year are as follows:

	Pension benefits	Postretirement benefits	Total
Prior service cost (credit)	\$ —	(1,179)	(1,179)
Net actuarial loss (gain)	<u>20,899</u>	<u>(980)</u>	<u>19,919</u>
	<u>\$ 20,899</u>	<u>(2,159)</u>	<u>18,740</u>

THE AMERICAN NATIONAL RED CROSS

Notes to Consolidated Financial Statements

June 30, 2017

(with summarized information for the year ended June 30, 2016)

The accumulated benefit obligation for the pension plan was approximately \$2.5 billion and \$3 billion as of June 30, 2017 and 2016, respectively.

The weighted average assumptions used to determine benefit obligations for 2017 and 2016 were as follows:

	Pension benefits		Postretirement benefits	
	2017	2016	2017	2016
Discount rate	4.22%	4.20%	3.70%	3.50%
Rate of compensation increase	5.00	5.00	—	—

The weighted average assumptions used to determine net benefit cost for 2017 and 2016 were as follows:

	Pension benefits		Postretirement benefits	
	2017	2016	2017	2016
Discount rate	4.20%	5.01%	3.50%	4.45%
Expected return on plan assets	6.50	6.50	—	—
Rate of compensation increase	5.00	5.00	—	—

The expected rate of return assumption on Plan assets was determined by considering current economic and market conditions and by reviewing asset class allocations, historical return analysis and forward looking capital market expectations. Asset class allocations were established by considering each class' risk premium commensurate for the level of risk, duration that matches the Plan's liabilities, and incremental diversification benefits. Historical returns and forward looking capital market expectations were gathered from, and compared among the Plan's investment managers, and a sampling of the consultant community.

For measurement purposes, approximately a 7.3% annual rate of increase in the per capita cost of covered health care benefits was assumed for fiscal year 2017. The rate was assumed to decrease gradually to 5% through 2025 and remain at that level thereafter. An 7.6% annual rate of increase in the per capita cost of covered health care benefits was assumed for fiscal year 2016. The rate was assumed to decrease gradually to 5% through 2023 and remain at that level thereafter.

THE AMERICAN NATIONAL RED CROSS

Notes to Consolidated Financial Statements

June 30, 2017

(with summarized information for the year ended June 30, 2016)

The components of net periodic benefit cost (credit) for the years ended June 30, 2017 and 2016 were as follows (in thousands):

	Pension benefits		Postretirement benefits	
	2017	2016	2017	2016
Service cost	\$ 805	1,031	133	153
Interest cost	123,709	132,400	2,296	2,810
Expected return on plan assets	(131,108)	(133,631)	—	—
Amortization of prior service credit	—	—	(1,180)	(687)
Curtailment gain	—	—	—	(71)
Net amortization loss (gain)	<u>29,701</u>	<u>18,261</u>	<u>(106)</u>	<u>(1,261)</u>
Net periodic benefit cost (credit)	\$ <u>23,107</u>	<u>18,061</u>	<u>1,143</u>	<u>944</u>

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A one-percentage point change in assumed health care cost trend rates would have the following effects (in thousands):

	Point increase	Point decrease
Effect on total of service and interest cost components	\$ 4	(3)
Effect on postretirement benefit obligation	120	(106)

The minimum funding requirement for the pension plan during the year ending June 30, 2018 is \$66.1 million.

THE AMERICAN NATIONAL RED CROSS

Notes to Consolidated Financial Statements

June 30, 2017

(with summarized information for the year ended June 30, 2016)

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid, as of June 30, (in thousands):

	Pension benefits	Postretirement benefits
2018	\$ 112,581	3,792
2019	117,505	3,892
2020	122,153	3,921
2021	126,742	3,981
2022	130,794	4,022
2023–2027	<u>702,677</u>	<u>19,866</u>
	\$ <u>1,312,452</u>	<u>39,474</u>

The Organization has investment guidelines for the Retirement System (the Plan) assets. The overall objective of the guidelines is to ensure the Plan assets provide capital growth over an extended period of time, while also considering market risks and ensuring that the portfolio income and liquidity are appropriate to meet the Plan benefit payments and other expenses. The Plan investments are required to be diversified by asset class and within each asset class such that no single investment would have a disproportionate impact on the total portfolio. The Plan asset allocation is reviewed each year with current market assumptions to re-align the asset mix with the long-term investment goals for the Plan. (See Note 4 for descriptions of the methodologies used to value Plan assets, except for the equity interest in the par annuity and guaranteed accumulation fund which are valued based on significant unobservable inputs including discounted cash flow analysis, comparable analysis, or third party appraisals. See note 4 for the definitions of Levels 1, 2, and 3.)

The Plan assets were invested in the following categories at June 30, 2017 and 2016:

	Pension assets	
	2017	2016
Cash and short-term investments	5 %	3 %
Equity	37	17
Fixed income	23	38
Marketable and nonmarketable alternative funds	<u>35</u>	<u>42</u>
	<u>100 %</u>	<u>100 %</u>

The Plan assets were within authorized asset allocation ranges at June 30, 2017 and 2016.

THE AMERICAN NATIONAL RED CROSS

Notes to Consolidated Financial Statements

June 30, 2017

(with summarized information for the year ended June 30, 2016)

The following table represents pension plan assets that are measured at fair value on a recurring basis at June 30, 2017 (in thousands):

	<u>June 30, 2017</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Measured at NAV(1)</u>
Fixed income commingled funds \$	286,031	—	286,031	—	—
Equity commingled funds	303,162	—	303,162	—	—
Hedge funds	478,991	—	—	3	478,988
Private equity and debt	224,614	—	—	5,299	219,315
Real estate and real assets	57,445	—	—	—	57,445
Equity interest in participating annuity surplus	86,758	—	—	86,758	—
Guaranteed accumulation fund	34,205	—	—	34,205	—
Derivative contracts	22,029	1,801	20,228	—	—
Cash and cash equivalents	274,106	55,163	218,943	—	—
Total Plan Assets	\$ <u>1,767,341</u>	<u>56,964</u>	<u>828,364</u>	<u>126,265</u>	<u>755,748</u>

The following table represents pension plan assets that are measured at fair value on a recurring basis at June 30, 2016 (in thousands):

	<u>June 30, 2016</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Measured at NAV(1)</u>
US government and sovereign securities \$	195,904	149,049	46,855	—	—
Fixed income commingled funds	408,773	—	408,773	—	—
Equity commingled funds	146,340	—	146,340	—	—
Hedge funds	659,684	—	—	24	659,660
Private equity and debt	286,271	—	—	5,905	280,366
Real estate and real assets	48,516	—	—	10,391	38,125
Equity interest in participating annuity surplus	60,376	—	—	60,376	—
Guaranteed accumulation fund	38,307	—	—	38,307	—
Derivative contracts	29,208	—	29,208	—	—
Cash and cash equivalents	106,018	3,601	102,417	—	—
Total Plan Assets	\$ <u>1,979,397</u>	<u>152,650</u>	<u>733,593</u>	<u>115,003</u>	<u>978,151</u>

- (1) Certain investments are measured at fair value using NAV as a practical expedient and have not been classified in the fair value hierarchy. The NAV amounts have been presented to permit reconciliation of the fair value hierarchy to the amounts presented as total plan assets.

THE AMERICAN NATIONAL RED CROSS

Notes to Consolidated Financial Statements

June 30, 2017

(with summarized information for the year ended June 30, 2016)

The following tables presents the activity of the assets of the Organization's defined benefit plan for assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the years ended June 30, 2017 and 2016 (in thousands):

	Balance as of June 30, 2016	Purchases	Settlements	Change in unrealized gains/ (losses)	Balance as of June 30, 2017
Hedge funds	\$ 24	—	(2,489)	2,468	3
Private equity and debt	5,905	—	(766)	160	5,299
Real estate and real assets	10,391	38	(17,555)	7,126	—
Equity interest in participating annuity surplus	60,376	23,921	(7,502)	9,963	86,758
Guaranteed accumulation fund	38,307	571	(4,599)	(74)	34,205
Total Plan Assets	\$ 115,003	24,530	(32,911)	19,643	126,265

	Balance as of June 30, 2015	Purchases	Settlements	Change in unrealized gains/ (losses)	Balance as of June 30, 2016
Hedge funds	\$ 23	1	—	—	24
Private equity and debt	5,927	25	(332)	285	5,905
Real estate and real assets	12,829	237	(1,657)	(1,018)	10,391
Equity interest in participating annuity surplus	75,280	—	(11,569)	(3,335)	60,376
Guaranteed accumulation fund	32,414	—	(1,528)	7,421	38,307
Total Plan Assets	\$ 126,473	263	(15,086)	3,353	115,003

On behalf of the Plan, the Organization transacts in a variety of derivative instruments, including swaps and options, for investment and hedging purposes, in order to create or mitigate certain exposures. Each instrument's primary underlying exposure is interest rates, equities, commodities, or currencies. Such contracts involve, to varying degrees, risks of loss from the possible inability of counterparties to meet the terms of their contracts. In the case of over-the counter derivatives, collateralization and daily marks-to-market mitigate counterparty risk. The Organization also invests in highly liquid, exchange-traded contracts to achieve exposure to U.S. Treasury securities; these contracts are also marked-to-market daily, with daily exchanges of variation margin, but do not require collateralization per se. Foreign exchange derivatives can be used to facilitate trade purchases and sales as well as for hedging purposes.

The Plan may use derivatives to hedge interest rate exposure for a portion of its pension liabilities. The liabilities are valued via a "discount rate" of investment grade corporate bonds. Uncertainty of future discount rates adds variability to Plan valuations and future cash flows. During the first part of fiscal year ended June 30, 2017, the Plan used interest rate swaption agreements, which are

THE AMERICAN NATIONAL RED CROSS

Notes to Consolidated Financial Statements

June 30, 2017

(with summarized information for the year ended June 30, 2016)

over-the-counter derivative instruments, to manage interest rate exposure; during the later portion of the year, the Plan used exchange traded U.S. Treasury futures to manage interest rate exposure. Management of interest rate exposure may change over time based upon a variety of factors, such as market conditions, perceived investment opportunities and risks, and investment goals and objectives.

The following table lists the notional/contractual amount of derivatives by contract type included in pension plan assets at June 30, 2017 and 2016 (in thousands):

Derivative type		2017	2016
Interest rate contracts	\$	302,161	880,000
Equity contracts		230,037	180,000

The following table lists fair value of derivatives by contract type included in pension plan assets as of June 30, 2017 and 2016 (in thousands):

Derivative type	Derivative assets		Derivative liabilities	
	2017	2016	2017	2016
Interest rate contracts	\$ 1,801	115,908	—	87,235
Equity contracts	20,274	535	46	—
Fair value of derivatives included in investments	\$ 22,075	116,443	46	87,235

The following table lists gains and losses on derivatives by contract type included in actual return on plan assets available for plan benefits as of June 30, 2017 and 2016 (in thousands):

Derivative type	Realized gains/(losses)		Change in unrealized gains/(losses)	
	2017	2016	2017	2016
Interest rate contracts	\$ 12,208	13,205	(26,871)	46,231
Equity contracts	11,452	(4,616)	3,131	(1,414)
Total	\$ 23,660	8,589	(23,740)	44,817

For the valuation of the Plan's derivative contracts at June 30, 2017, the Plan used significant other observable inputs as of the valuation date (Level 2), including prices of instruments with similar maturities and characteristics, interest rate yield curves, measures of interest rate volatility and various market indices. The value was determined and adjusted to reflect nonperformance risk of both the counterparty and the Plan.

THE AMERICAN NATIONAL RED CROSS

Notes to Consolidated Financial Statements

June 30, 2017

(with summarized information for the year ended June 30, 2016)

(b) American National Red Cross Savings Plan – 401(k) Plan

The Organization sponsors the American Red Cross Savings Plan (the Savings Plan), a defined contribution plan. In general, employees are eligible to participate upon hire and vest in employer contributions on a three year cliff schedule. Employer contributions include Red Cross Match only. There were \$32.5 million and \$32.1 million in Red Cross employer contributions to the Savings Plan in 2017 and 2016, respectively.

For the 2017 calendar year, contribution limits were based on a maximum annual compensation of \$270,000, and a maximum Red Cross match of \$10,800 (\$270,000 X 4%). Also, \$18,000 the maximum pre-tax contribution for those under age 50 in 2017. Those eligible for age 50 and over catch-up could have contributed an additional unmatched pre-tax amount of \$6,000 in 2017. After-tax contribution were also available. As of June 30, 2017, there were 10 target retirement date and 6 core investment options that an employee could choose from along with a self-managed brokerage account option.

(11) Receivables Securitization Program

The Organization has an asset securitization program. The program is structured to sell the eligible biomedical hospital account receivables, without legal recourse, to a third party investor, through a wholly owned bankruptcy-remote special purpose entity that is consolidated for financial reporting purposes. The Organization continues servicing the sold receivables. Proceeds received under the securitization program are treated as secured borrowings. The maximum amount of the agreement is \$125 million for years ended June 30, 2017 and 2016 and the total cost of the program approximates the 30 day Libor plus 1%. At June 30, 2017 and 2016, the amount of outstanding borrowings under the securitization program was \$113 million and \$110 million, respectively, and is included in other current liabilities on the statement of financial position.

(12) Commitments and Contingencies

(a) Litigation

The Organization is a defendant in a number of lawsuits incidental to its operations. In the opinion of management, the outcome of such lawsuits will not have a materially adverse effect on the Organization's financial position.

(b) Government Grants

Costs charged to the federal government under cost-reimbursement grants and contracts are subject to government audit. Therefore, all such costs are subject to adjustment. Management believes that adjustments, if any, would not have a significant effect on the consolidated financial statements.

(13) Subsequent Events

The Organization has evaluated subsequent events through the date the consolidated financial statements were issued, October 6, 2017.