Consolidated Financial Statements and Supplementary Information

CHRISTUS Health
Years Ended June 30, 2017 and 2016
With Reports of Independent Auditors

Ernst & Young LLP

Building a better working world

CHRISTUS Health

Consolidated Financial Statements
and Supplementary Information

Years Ended June 30, 2017 and 2016

Contents

Building a better working world

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Report of Independent Auditors

The Board of Directors
CHRISTUS Health

We have audited the accompanying consolidated financial statements of CHRISTUS Health, which comprise the consolidated balance sheets as of June 30, 2017 and 2016, and the related consolidated statements of operations and changes in net assets and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

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Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of CHRISTUS Health at June 30, 2017 and 2016, and the consolidated results of its operations and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Ernst & Young LLP

September 15, 2017

A member firm of Ernst & Young Global Limited

CHRISTUS Health

Consolidated Balance Sheets

	June 30	
	2017	**2016**
	(In Thousands)	
Assets		
Current assets:		
Cash and cash equivalents	**$ 528,259**	$ 483,664
Short-term investments and equity in managed funds	**586,560**	620,490
Assets whose use is limited or restricted, required for current liabilities	**58,831**	58,387
Patient accounts receivable, net of allowance for doubtful accounts of $310,089 and $171,926 at June 30, 2017 and 2016, respectively	**505,480**	456,609
Notes and other receivables	**207,012**	127,039
Inventories	**105,104**	93,415
Other current assets	**103,142**	86,239
Total current assets	**2,094,388**	1,925,843
Assets whose use is limited or restricted, less current portion	**709,925**	869,085
Property and equipment, net of accumulated depreciation	**2,358,676**	1,940,183
Other assets:		
Investments in unconsolidated organizations	**150,823**	148,095
Goodwill and intangible assets, net	**132,668**	136,661
Beneficial interest in supporting organizations and other restricted assets	**87,730**	86,154
Other assets, including notes receivable from related party	**202,173**	105,536
Total other assets	**573,394**	476,446
Total assets	**$ 5,736,383**	$ 5,211,557

	June 30	
	2017	**2016**
	(In Thousands)	
Liabilities and net assets		
Current liabilities:		
Accounts payable and accrued expenses	**$ 568,881**	$ 461,529
Accrued employee compensation and benefits	**252,139**	204,615
Estimated third-party settlements, net	**62,782**	37,698
Current portion of long-term debt	**44,880**	55,815
Total current liabilities	**928,682**	759,657
Long-term debt, less current portion	**1,117,125**	970,718
Accrued pension benefits	**170,356**	209,334
Derivative financial instruments	**116,160**	168,520
Other long-term obligations – including self-funded liabilities, less current portion	**227,601**	171,621
Total liabilities	**2,559,924**	2,279,850
Net assets		
Unrestricted:		
Attributable to CHRISTUS Health	**2,798,703**	2,599,043
Attributable to non-controlling interest	**201,855**	152,802
Total unrestricted	**3,000,558**	2,751,845
Temporarily restricted	**159,021**	162,985
Permanently restricted	**16,880**	16,877
Total net assets	**3,176,459**	2,931,707
Total liabilities and net assets	**$ 5,736,383**	$ 5,211,557

See accompanying notes.

CHRISTUS Health

Consolidated Statements of Operations and Changes in Net Assets

	Year Ended June 30	
	2017	**2016**
	(In Thousands)	
Revenues:		
Patient service revenue (net of contractual allowances and discounts)	**$ 4,844,925**	$ 3,585,511
Provision for bad debts	**(459,803)**	(267,631)
Net patient service revenue less provision for bad debts	**4,385,122**	3,317,880
Premium revenue	**216,706**	189,878
Inherent contribution from business combination	**73,101**	474,540
Other revenue	**238,385**	205,385
Equity in income of unconsolidated organizations	**9,115**	24,730
Total revenues	**4,922,429**	4,212,413
Expenses:		
Employee compensation and benefits	**2,247,498**	1,680,930
Services and other	**1,506,767**	1,267,389
Supplies	**834,718**	654,272
Goodwill impairment charge	**–**	91,916
Depreciation and amortization, including impairment	**215,039**	195,698
Interest	**37,167**	22,278
Total expenses	**4,841,189**	3,912,483
Operating income	**81,240**	299,930
Non-operating investment gain (loss)	**95,388**	(71,573)
Other non-operating loss	**(3,524)**	(815)
Revenues in excess of expenses	**173,104**	227,542
Less revenues in excess of expenses attributable to non-controlling interest	**31,735**	6,912
Revenues in excess of expenses attributable to CHRISTUS Health	**141,369**	220,630

CHRISTUS Health

Consolidated Statements of Operations and Changes in Net Assets (continued)

	Year Ended June 30	
	2017	**2016**
	(In Thousands)	
Changes in unrestricted net assets:		
Revenues in excess of expenses attributable to CHRISTUS Health	**$ 141,369**	$ 220,630
Unrealized gain (loss) on investments	**3,427**	(3,085)
Change in pension liabilities	**20,688**	(85,055)
Change in non-controlling interest	**49,053**	8,099
Net assets released from restrictions for capital and other	**34,176**	(278)
Changes in unrestricted net assets	**248,713**	140,311
Temporarily restricted net assets:		
Temporarily restricted net assets acquired	**646**	11,258
Net change in beneficial interest	**1,141**	(999)
Contributions	**23,862**	13,692
Unrealized gain (loss) on investments	**707**	(905)
Net assets released from restrictions and other	**(30,320)**	(15,740)
Changes in temporarily restricted net assets	**(3,964)**	7,306
Permanently restricted net assets:		
Permanently restricted net assets acquired	**–**	2,404
Net change in beneficial interest	**(131)**	(132)
Other	**134**	(158)
Changes in permanently restricted net assets	**3**	2,114
Change in net assets	**244,752**	149,731
Net assets – beginning of year	**2,931,707**	2,781,976
Net assets – end of year	**$ 3,176,459**	$ 2,931,707

See accompanying notes.

CHRISTUS Health

Consolidated Statements of Cash Flows

	Year Ended June 30 2017	2016
	(In Thousands)	
Operating activities		
Changes in net assets	**$ 244,752**	$ 149,731
Adjustments to reconcile changes in net assets to net cash provided by operating activities:		
Inherent contribution from business combination	**(73,101)**	(474,540)
Change in beneficial interest	**1,009**	1,131
Change in pension liabilities recognized in net assets	**(20,688)**	85,055
Contributions of temporarily restricted net assets	**(23,862)**	(13,962)
Distributions to and acquisitions of non-controlling interest, net	**7,433**	11,429
Restricted assets acquired in business combination	**(646)**	(13,662)
Non-controlling interest acquired in business combination	**(20,784)**	(12,181)
Equity in income of unconsolidated organizations	**(9,115)**	(24,730)
Unrealized investment loss	**21,280**	25,724
Depreciation and amortization	**215,039**	195,698
Amortization of deferred financing costs	**1,128**	1,288
Provision for bad debts	**459,803**	267,631
Goodwill impairment charge	**–**	91,916
Change in derivative fair value	**(52,360)**	59,348
Loss on extinguishment of debt	**1,816**	–
Gain (loss) on disposal of property and equipment	**483**	(695)
Foreign currency translation (gain) loss	**(7,062)**	14,437
Changes in operating assets and liabilities, net of acquisitions:		
Increase in net patient accounts receivable	**(466,051)**	(282,462)
Decrease in investments	**232,876**	181,834
(Increase) decrease in notes and other receivables	**(45,488)**	78,090
Increase in other current assets and inventories	**(16,299)**	(19,473)
Increase in accounts payable, accrued expenses, and accrued employee compensation and benefits	**90,127**	40,235
Increase in net third-party payor settlements	**26,601**	5,189
Decrease in other long-term liabilities	**(43,032)**	(19,570)
Net cash provided by operating activities	**523,859**	347,461
Investing activities		
Purchases of property and equipment	**(343,689)**	(215,503)
Proceeds from sale or disposal of property and equipment	**49**	285
Proceeds and dividends from sale of equity investment in unconsolidated subsidiaries	**21,570**	19,806
Distributions from investments in unconsolidated organizations	**10,722**	11,693
Purchases of and additional contributions to equity method investments	**(44,683)**	–
Notes issued to related parties	**(28,370)**	–
Increase in other assets	**(61,435)**	(3,514)
Acquisitions of health care entities, net of cash acquired	**23,251**	23,588
Net cash used in investing activities	**(422,585)**	(163,645)

Consolidated Statements of Cash Flows (continued)

	Year Ended June 30	
	2017	**2016**
	(In Thousands)	
Financing activities		
Contributions of temporarily restricted net assets	**$ 23,862**	$ 13,692
Costs associated with debt refinancing/conversion	**(983)**	(1,732)
Proceeds from issuance of new debt	**263,205**	–
Payments on long-term debt	**(335,330)**	(50,371)
Distributions to and acquisitions of non-controlling interest, net	**(7,433)**	(11,429)
Net cash used in financing activities	**(56,679)**	(49,840)
Net increase in cash and cash equivalents	**44,595**	133,976
Cash and cash equivalents – beginning of year	**483,664**	349,688
Cash and cash equivalents – end of year	**$ 528,259**	$ 483,664
Non-cash investing and financing transactions		
Capital lease and debt obligations incurred for property and equipment	**$ 66,682**	$ 5,092
Note received for sale of investment in unconsolidated entity	**$ 21,570**	$ –
See Note 19 for non-cash investing transactions related to business combination transactions		
Supplemental disclosure of cash flow information		
Cash paid during the year for interest (net of amount capitalized)	**$ 34,622**	$ 33,813

See accompanying notes.

1. Mission, Vision, and Organization of CHRISTUS Health

CHRISTUS Health (CHRISTUS or the System) was incorporated as a Texas nonprofit corporation on December 15, 1998. CHRISTUS is sponsored by the Congregation of the Sisters of Charity of the Incarnate Word of Houston, Texas, and the Congregation of the Sisters of Charity of the Incarnate Word of San Antonio, Texas, and effective May 1, 2016, CHRISTUS added a third sponsoring congregation, the Sisters of the Holy Family of Nazareth.

The mission of CHRISTUS is to extend the healing ministry of Jesus Christ. The Gospel values underlying the mission statement challenge CHRISTUS to make choices that respond to the economically disadvantaged and the underserved with health care needs. The growth and development of CHRISTUS are determined by the health care needs of the communities that CHRISTUS serves, its available resources, and the interrelationship of those serving and those being served. Responsible stewardship mandates that CHRISTUS searches out new, effective means to deliver quality health care and to promote wholeness in the human person.

The vision of CHRISTUS is to be a leader, a partner, and an advocate in the creation of innovative health and wellness solutions that improve the lives of individuals and communities so that all may experience God's healing presence and love.

The consolidated financial statements of CHRISTUS include activities of its affiliated market-based organizations and other related entities, all of which are wholly or majority owned or otherwise controlled. For purposes of these consolidated financial statements, the System is defined as CHRISTUS' affiliated market-based organizations and other related entities. The other related entities include, but are not limited to, hospital foundations, professional office buildings, management services organizations, physician groups, outpatient surgery centers, diagnostic imaging companies, urgent care centers, a collection agency, self-insurance trusts, an offshore captive insurance company, health plans, and integrated community health networks.

CHRISTUS controls or owns, directly or indirectly, or manages various nonprofit and for-profit corporations and other organizations that currently operate domestically in the states of Texas, Arkansas, Georgia, Louisiana, New Mexico, Iowa, and internationally in Grand Cayman, Mexico, Chile and Colombia.

CHRISTUS and certain affiliated nonprofit corporations are generally exempt from federal income taxes under Section 501(a) of the Internal Revenue Code, as organizations described in Section 501(c)(3).

2. Community Health

In accordance with its mission and philosophy, the System commits significant resources to improving the health of the communities it serves. In support of its mission, the System provides programs and services for entire communities, with a special consideration for those who are poor and underserved.

CHRISTUS and various hospital participants have elected to provide health care services to the indigent population both directly to patients as charity services and by providing financial support to one another for certain community benefit efforts provided throughout the year with the goal being to reach a previously discussed equitable distribution of the cost of care to the low-income and needy populations in the communities they service.

Programs and Services for the Poor and Underserved

These programs and services represent the financial commitment to serve those who have inadequate resources and/or are uninsured or underinsured. Services are offered with the conviction that health care is a basic human right and all deserve access. The categories included as programs and services for the poor and the underserved are as follows:

Charity Care – In accordance with the Catholic Health Association (CHA) guidelines, charity care represents the unpaid costs of free or discounted health services provided to persons who cannot afford to pay and who meet the organization's criteria for financial assistance. Traditional charity care is defined by the State of Texas as the unreimbursed costs of providing, funding, or otherwise financially supporting the health care services provided to a person with income at or below 200% of the federal poverty level. Charity care services provided to these patients are not reported as revenue in the consolidated statements of operations and changes in net assets as there is no expectation of payment. The amount of traditional charity care provided, determined on the basis of cost, estimated using the applicable cost to charge ratios of the hospital participants, excluding the provision for bad debt expense, was $246,550,000 and $215,404,000 for the years ended June 30, 2017 and 2016, respectively.

Unpaid Costs of Medicaid and Other Public Programs for the Indigent – This category represents the cost of providing services to beneficiaries of public programs, including state Medicaid and indigent care programs, in excess of any payments received from all sources.

2. Community Health (continued)

Community Services for the Poor and Underserved **–** This category represents the unpaid cost of services provided for which a patient is not billed or for which a fee has been assessed that recovers only a portion of the cost of the rendered service. This category includes services to those in need through community health programs. The programs cover a broad spectrum of services, including community health centers, immunizations for children and seniors, Meals on Wheels, transportation services, home repair projects, and a variety of other social services. These programs may also seek justice for the vulnerable and work to bring about changes in political and economic systems.

Community Services Provided for the Broader Community **–** This category represents the unpaid cost of services provided for the benefit of the entire community. The majority of these expenditures are for graduate medical education programs, either through CHRISTUS-sponsored or affiliated programs. Other benefits for the broader community include health promotion and wellness programs, health screenings, newsletters, and radio or television programs intended for health education. These programs are not intended to be financially self-supporting.

Education and Research **–** This category represents the direct costs associated with medical education and other health professional educational programs in excess of governmental payments.

Other Community Services **–** This category represents leadership activities, community planning, and advocacy.

3. Summary of Significant Accounting Policies

Basis of Consolidation

The consolidated financial statements include the accounts of all entities of the System (see Note 1). All significant inter-entity transactions and accounts have been eliminated in consolidation.

Use of Estimates

The preparation of the accompanying consolidated financial statements in conformity with accounting principles generally accepted in the United States (U.S. GAAP) requires management of the System to make assumptions, estimates, and judgments that affect the amounts reported in the financial statements, including the notes thereto, and related disclosures of commitments and

3. Summary of Significant Accounting Policies (continued)

contingencies, if any. The System considers critical accounting policies to be those that require more significant judgments and estimates in the preparation of its financial statements, including the following: recognition of net patient service revenues, which include contractual allowances and the provision for bad debt; estimates for reimbursement under the upper payment limit, disproportionate share and Medicaid 1115 waiver programs; reserves for losses and expenses related to health care professional and general liabilities; accruals for claims incurred but not yet reported related to the System's health plan; determination of fair values of certain financial instruments; determination of fair value of certain goodwill and long-lived assets, including assets acquired; and risks and assumptions for measurement of pension and retiree medical liabilities. Management relies on historical experience and on other assumptions believed to be reasonable under the circumstances in making its judgments and estimates. Actual results could differ materially from these estimates.

Cash and Cash Equivalents and Investments

Cash equivalents include short-term, highly liquid investments with original maturities of three months or less.

The System's investment portfolio is classified as trading, with unrealized gains and losses included in revenues in excess of expenses. Certain investments held by the System's foundations are classified as other than trading, with unrealized gains and losses included in changes in net assets. Investments in equity securities and funds with readily determinable fair values and all investments in debt securities are measured at fair value in the consolidated balance sheets. Investments also include equity investments in managed funds structured as limited liability corporations or partnerships. Equity investments in managed funds are accounted for under the fair value method if held within the System's foundations or captive insurer, or under the equity method if held by another System entity. Investment income or loss (including equity investment earnings (losses) on equity investments in managed funds; realized and unrealized gains and losses, computed on the average-cost basis of the security at the time of sale; and interest and dividends) is included in revenues in excess of expenses unless the income or loss is restricted by donor or law.

Investment income earned on assets held by trustees under bond indenture agreements, assets held by foundations, assets deposited in trust funds for self-insurance purposes, and funds held by insurance subsidiaries in accordance with industry practices are included in other revenue in the consolidated statements of operations and changes in net assets.

3. Summary of Significant Accounting Policies (continued)

Derivative Financial Instruments

The System utilizes interest rate swaps to mitigate interest rate exposures. Changes in the fair value of the System's interest rate swaps are recorded as a component of non-operating investment gain (loss) in the accompanying consolidated statements of operations and changes in net assets. The expense representing the net of the payments made and received under the swap agreements is also recorded as a component of non-operating investment gain (loss).

Inventories

The System values inventories, which consist principally of medical supplies and pharmaceuticals, at the lower of cost (first-in, first-out or weighted average cost valuation method) or market basis.

Property and Equipment

Property and equipment acquisitions are recorded at historical cost or, if donated, impaired, or acquired in a business transaction, at fair value at the time of donation, impairment, or acquisition. Expenditures that materially increase values, change capacities, or extend useful lives are capitalized. Routine maintenance, repairs, and minor equipment replacement costs are charged against operations.

Depreciation is calculated and recorded over the estimated useful life of each class of depreciable assets using the straight-line method. The *American Hospital Association – Estimated Useful Lives of Depreciable Hospital Assets* is used as a general guide in establishing depreciable lives. Amortization of capital leases and impairment losses related to long-lived assets are included in depreciation expense.

Asset Impairment

The System periodically evaluates the carrying value of its operating long-lived assets and assets held for sale for impairment when indicators of impairment are identified. These evaluations are primarily based on the estimated recoverability of the assets' carrying value. Impairment write-downs are recognized as a reduction in operating income for the operating long-lived assets and as a reduction in non-operating gain for the assets held for sale at the time the impairment is

3. Summary of Significant Accounting Policies (continued)

identified. Impairment losses of $10,756,000 and $31,117,000 were recorded as depreciation expense in fiscal years 2017 and 2016, respectively. In determining the amount of the impairment, the fair values of the affected assets were estimated primarily using a discounted cash flow methodology.

Investments in Unconsolidated Organizations

The System has investments in certain organizations for which it does not have a majority ownership interest or control, and therefore, these organizations are not consolidated. Generally, these investments are recorded using the equity method of accounting for those organizations in which the System owns greater than 20% and has significant influence over the organization. The cost method of accounting is used for organizations in which the System owns 20% or less (see additional discussion in Note 8).

Non-controlling Interest in Consolidated Subsidiaries

The System attributed revenues in excess of expenses of $31,735,000 and $6,912,000 for the years ended June 30, 2017 and 2016, respectively, to the non-controlling interest based on the contractual terms of joint ventures and the ownership percentage of the non-controlling interests in certain of the consolidated subsidiaries. These amounts are reflected in unrestricted net assets in the consolidated balance sheets, net of distributions.

Goodwill and Intangible Assets

Goodwill and intangible assets recorded in connection with acquisitions completed by the System are accounted for under Accounting Standards Codification (ASC) 350, *Intangibles – Goodwill and Other*. The System records goodwill as the excess of purchase price over the fair value of identifiable tangible and intangible assets acquired and liabilities assumed. Indefinite-lived intangible assets consist entirely of a trade name asset recorded in connection with the Trinity Mother Frances Health System acquisition in fiscal year 2016. Finite-lived intangible assets consist primarily of non-compete assets generated from prior business combinations and minimum revenue guarantees offered to various non-employed physicians throughout the System. At June 30, 2017 and 2016, the System had goodwill and intangible assets, net, of $132,668,000 and $136,661,000, respectively.

3. Summary of Significant Accounting Policies (continued)

The changes in the carrying amounts of goodwill and intangible assets as of June 30 are as follows (in thousands):

	Goodwill	Indefinite-Lived Asset	Finite-Lived Assets
Balance at July 1, 2015	$ 144,880	$ –	$ 10,078
Assets acquired	25,398	46,000	7,642
Impairment charges	(91,916)	–	–
Amortization	–	–	(5,846)
Currency translation and purchase price adjustments for prior years' acquisitions	148	–	277
Balance at June 30, 2016	78,510	46,000	12,151
Assets acquired	**–**	**–**	**2,777**
Impairment charges	**–**	**–**	**–**
Amortization	**–**	**–**	**(4,459)**
Currency translation and other adjustments	**235**	**–**	**(2,546)**
Balance at June 30, 2017	**$ 78,745**	**$ 46,000**	**$ 7,923**

Goodwill is tested at least annually for impairment at the reporting unit level on April 1 of each year. Impairment is the condition that exists when the carrying amount of goodwill exceeds its implied fair value. Additional impairment assessments may be performed on an interim basis if the System encounters events or changes in circumstances that would indicate that it is more likely than not that the carrying value has been impaired. The System has determined that its reporting units are the various geographically located affiliates.

For goodwill impairment tests, the System may elect to perform a qualitative assessment of each reporting unit to determine whether facts and circumstances support a determination that the reporting unit's fair value is greater than its carrying value. If the qualitative analysis is not conclusive, or if the System elects to proceed directly with quantitative testing, the fair values of the reporting units are determined and compared to the aggregate carrying values.

3. Summary of Significant Accounting Policies (continued)

The System follows a two-step, fair value-based process using a discounted cash flow income method, a guideline public company method, and a mergers and acquisitions method to determine if an impairment of goodwill exists. This analysis requires judgments and estimates about the weighted average cost of capital, risk factors, and forecasted operating margins. The first step compares the fair value of the reporting unit to its carrying amount, including goodwill. If the carrying amount of the reporting unit exceeds its fair value, the second step is performed. The second step requires an allocation of fair value to the individual assets and liabilities of the reporting unit to determine the implied fair value of goodwill. If the implied fair value of goodwill is less than the carrying amount, an impairment loss is recorded as a reduction to goodwill and a charge to impairment expense. Judgments and assumptions are inherent in the System’s estimates used to determine the fair value of its reporting units and are consistent with what the System believes would be utilized by the primary market participant. The use of alternative judgments and assumptions could result in the recognition of different impairment charges in the System’s consolidated financial statements.

The System’s practice is to perform a quantitative analysis on reporting units carrying significant goodwill at least every third year or more frequently, if impairment is indicated. A qualitative assessment is performed for reporting units not subject to a quantitative analysis for a given fiscal year.

As a result of the qualitative assessment for the year ended June 30, 2017, no impairment losses were recorded. An impairment loss of $91,916,000 was recorded during the year ended June 30, 2016, which resulted from the 2016 quantitative analysis of the affected reporting units. Recurring operating losses in the System’s Santa Rosa region was the primary driver for the decline in value of the related reporting unit and resulting impairment in fiscal year 2016.

Indefinite-lived intangible assets are also tested annually for impairment on April 1 of each year, by comparing the fair value of the asset with its carrying amount. The System also considers facts and circumstances surrounding the asset on an annual basis to determine if an indefinite life continues to be appropriate. For indefinite-lived intangible asset impairment tests, the System also may elect to perform a qualitative assessment to determine whether facts and circumstances support a conclusion that it is more likely than not that the asset is not impaired. If the qualitative analysis is not conclusive, or if the System elects to proceed directly with quantitative testing, the fair values of the intangible assets are determined and compared to their carrying amounts. No impairment losses on indefinite-lived intangible assets were recognized in fiscal years 2017 and 2016.

3. Summary of Significant Accounting Policies (continued)

Finite-lived intangible assets are tested for impairment whenever indicators of impairment are identified. An impairment loss is recognized if the intangible asset is not recoverable and its carrying amount exceeds its fair value. No impairment losses on finite-lived intangible assets were recognized in fiscal years 2017 and 2016.

Deferred Financing Costs

Deferred financing costs, net of accumulated amortization, included as a reduction of long-term debt at June 30, 2017 and 2016, are $8,716,000 and $8,964,000, respectively, which are being amortized using the effective interest method over the terms of the indebtedness to which they relate. Amortization expense recognized for fiscal years 2017 and 2016 was $1,128,000 and $1,288,000, respectively.

Temporary and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by the System has been limited by donors to a specific time period or purpose. Temporarily restricted net assets also include the System's beneficial interest in the net assets of affiliated and financially interrelated organizations, whose use has been limited by grant agreements and donors to a specific time period or use.

Permanently restricted net assets have been restricted by donors to be maintained by the System in perpetuity.

Unconditional promises to give cash and other assets 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 gift is received. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the consolidated statements of operations and changes in net assets as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are reported as other revenue in the accompanying consolidated financial statements.

3. Summary of Significant Accounting Policies (continued)

Patient Accounts Receivable, Estimated Payables to Third-Party Payors, and Net Patient Service Revenue

The System has agreements with third-party payors that provide for payments to the System at amounts different from established rates. Patient accounts receivable and net patient service revenue are reported at the estimated net realizable amounts from third-party payors and others for services rendered. Estimated retroactive adjustments under reimbursement agreements with third-party payors are included in net patient service revenue and estimated third-party payor settlements. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as final settlements are determined.

Provision for Bad Debts

The System's recorded allowance for doubtful accounts is based on expected net collections, after contractual adjustments, primarily from patients. Management routinely assesses these recorded allowances relative to changes in payor mix, cash collections, write-offs, recoveries, and market dynamics.

A summary of activity in the System's allowance for doubtful accounts is as follows (in thousands):

	Balance at Beginning of Year	Provision for Bad Debts	Accounts Written Off, Net of Recoveries	Balance at End of Year
Year ended June 30, 2017	**$ 171,926**	**$ 459,803**	**$ (321,640)**	**$ 310,089**
Year ended June 30, 2016	129,072	267,631	(224,777)	171,926

The increase in the allowance for doubtful accounts and provision and write-off activity between fiscal years 2016 and 2017 is largely due to post-transaction activity stemming from the fiscal year 2016 and 2017 acquisitions (see Note 19).

3. Summary of Significant Accounting Policies (continued)

Premium Revenue and Associated Costs

Premium revenue largely represents revenues derived under capitated arrangements with third parties. In return for these premiums, CHRISTUS is responsible for providing essentially all health care services to enrolled participants. The System contracts with the Department of Defense (DOD) to treat TRICARE patients through a U.S. Family Health Plan. Premium revenue recognized under the contract with the DOD was 54.9% and 72.7% of total premium revenue at June 30, 2017 and 2016, respectively. Premium revenues are also generated by the System's health maintenance organization, CHIP and STAR programs, and for individual coverage on federal and state based health exchanges. The exchange revenues are subject to risk-sharing provisions as outlined in federal regulations. Additionally, a significant portion of these premiums are subsidized through the federal government's advance premium tax credit provisions. Changes to these programs could affect the ultimate realization of these revenues. Premium revenue for individual coverage on the federal and state based exchanges were 37.1% and 16.3% of total premium revenue at June 30, 2017 and 2016, respectively. Included in net premium revenues for individual coverage on federal and state based health exchanges is a reserve for risk sharing provisions under the Affordable Care Act of $15,711,000.

Costs for providing services through these contracts, including services provided by other health care providers, were $187,715,000 and $157,040,000 for the years ended June 30, 2017 and 2016, respectively, and are included in services and other expenses in the accompanying consolidated financial statements. At June 30, 2017 and 2016, the System has accrued expenses for incurred but not reported claims based upon claims experience. The System maintains stop-loss insurance coverage to limit exposure for certain catastrophic claims.

Other Revenue

Other revenue is derived from services other than providing health care services or coverage to patients, residents, or enrollees. This revenue typically includes investment income from all funds held by a trustee, malpractice funds, or other miscellaneous investment activities; fees for providing management services under the terms of management agreements with third parties and certain of the System's joint ventures; rental of health care facility space; sales of medical and pharmaceutical supplies to employees, physicians, and others; proceeds from sales of cafeteria meals and guest trays to employees, medical staff, and visitors; and proceeds from sales at gift shops and other retail activities or other service facilities operated by the health care organization.

3. Summary of Significant Accounting Policies (continued)

Income Taxes

The authoritative guidance in ASC 740, *Income Taxes*, creates a single model to address uncertainty in tax positions and clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. Under the requirements of this guidance, tax-exempt organizations could be required to record an obligation as the result of a tax position they have historically taken on various tax exposure items. CHRISTUS has interests in various taxable entities, including investments in Mexico and Chile. These interests may give rise to U.S. and international tax exposures. CHRISTUS intends to utilize foreign earnings in foreign operations for an indefinite period of time in order to continue investing all earnings into the continued maintenance and expansion of these operations abroad as part of the System's mission. If these amounts were distributed to the United States, in the form of dividends or otherwise, the System would be subject to additional U.S. income taxes. Determination of the amount of unrecognized deferred income tax liabilities on these earnings is not practicable because such liability, if any, depends on circumstances existing if and when remittance occurs. There are no material unrecorded tax liabilities as of June 30, 2017 and 2016.

At June 30, 2017 and 2016, CHRISTUS has operating loss carryforwards of $306,735,000 and $95,088,000, which result in deferred tax assets of $107,357,000 and $33,281,000, respectively. CHRISTUS has provided a valuation allowance of the same amount as it is more likely than not that the deferred tax asset will not be realized.

Business Combinations

CHRISTUS accounts for all transactions that represent business combinations in which it obtains control of the acquired entity using the acquisition method of accounting, where the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquired entity are recognized and measured at their fair values on the date the System obtains control of the acquiree. Such fair values that are not finalized for reporting periods following the acquisition date are estimated and recorded as provisional amounts. Adjustments to these provisional amounts during the measurement period (defined as the date through which all information required to identify and measure the consideration transferred, the assets acquired, the liabilities assumed and any non-controlling interests has been obtained, limited to one year from the acquisition date) are recorded as of the date of acquisition. Any material impact to comparative information for periods after

3. Summary of Significant Accounting Policies (continued)

acquisition, but before the period in which adjustments are identified, is reflected in those prior periods as if the adjustments were considered as of the acquisition date. Goodwill is determined as the excess of the fair value of the consideration conveyed in the acquisition over the fair value of the net assets acquired. An inherent contribution is recorded if the fair value of identifiable assets and liabilities acquired exceed the consideration conveyed.

New and Pending Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, enacting ASC 606, *Revenue from Contracts with Customers*, to clarify the principles for recognizing revenue and to improve financial reporting by creating common revenue recognition guidance for U.S. GAAP and International Financial Reporting Standards (IFRS). The core principle of the new guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 is now effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. Early adoption is permitted. The System is evaluating the guidance in ASU 2014-09 and the impact that the adoption of this update will have on its consolidated financial statements.

In February 2015, the FASB issued ASU 2015-02, *Amendments to the Consolidation Analysis*, which requires a revaluation of whether certain legal entities, including limited partnerships, should be consolidated, and eliminates the presumption that a general partner should consolidate a limited partnership. In January 2017, the FASB issued ASU 2017-02, *Clarifying When a Not-for-Profit Entity That Is a General Partner or a Limited Partner Should Consolidate a For-Profit Limited Partnership or Similar Entity*, which reinstates that presumption for not-for-profit organizations. ASU 2015-02 and ASU 2017-02 are effective for fiscal years and interim periods within those fiscal years, beginning after December 15, 2015, with early adoption permitted. Effective for the year ended June 30, 2017, the System adopted this guidance, which did not have a material impact to the System's consolidated financial statements.

In April 2015, the FASB issued ASU 2015-05 as an update to ASC 350-40, *Intangibles – Goodwill and Other – Internal-Use Software*. The update provides guidance on accounting for fees paid in a cloud computing arrangement. Previously, there was no such guidance under U.S. GAAP resulting in diversity in practice. The amendments in the update provide guidance to customers

3. Summary of Significant Accounting Policies (continued)

about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the software license element of the arrangement should be accounted for consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the arrangement should be accounted for as a service contract. The updated guidance is effective for annual periods beginning after December 15, 2015, and interim periods in annual periods beginning after December 15, 2016. The guidance can be adopted either (1) prospectively to all arrangements entered into or materially modified after the effective date or (2) retrospectively. Effective for the year ended June 30, 2017, the System adopted this guidance prospectively. The adoption of the guidance did not have a material impact to the System's consolidated financial statements.

In April 2015, the FASB issued authoritative guidance (ASU 2015-03) to simplify the presentation of debt issuance costs under ASC 835-30: *Interest – Imputation of Interest*. Consequently, the updated guidance requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs is not affected by the guidance. Further, the amortization of debt issuance costs shall be reported as interest expense. The updated guidance is effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within fiscal years beginning after December 15, 2016. The new guidance should be applied on a retrospective basis, wherein the balance sheet of each individual period presented should be adjusted to reflect the period-specific effects of applying the new guidance. The System adopted ASU 2015-03 for fiscal year 2017. The updated guidance resulted in a reclassification of the deferred debt issuance costs in other assets to long-term debt and a reclassification of debt issuance cost amortization in depreciation and amortization expense to interest expense. There was no other material impact to the System's consolidated financial statements resulting from the implementation of ASU 2015-03.

In February 2016, the FASB issued ASU 2016-02, enacting ASC 842, *Leases*, which requires a lessee to recognize a right-of-use asset and a lease liability for both operating and finance leases, whereas previous U.S. GAAP required the asset and liability be recognized only for capital leases. The amendment also requires qualitative and specific quantitative disclosures. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, with early adoption permitted. The System is evaluating the guidance of ASU 2016-02 and the impact that the adoption of this update will have on its consolidated financial statements.

3. Summary of Significant Accounting Policies (continued)

In August 2016, the FASB issued ASU 2016-14 *Presentation of Financial Statements of Not-for-Profit Entities*, as an update to ASC 958, *Not-for-Profit Entities*. This update makes several improvements to current reporting requirements that address complexities in the use of the currently required three classes of net assets and enhance required disclosures related to donor restrictions of net assets. The updated guidance will be effective for annual periods beginning after December 15, 2017, and interim periods within fiscal years beginning after December 15, 2018. Early adoption is permitted. The new guidance should be applied on a retrospective basis. The updated guidance will result in a change in the classes of net assets reported on the face of the statement of financial position from three classes (unrestricted, temporarily restricted, and permanently restricted) to two classes (net assets without donor restrictions and net assets with donor restrictions). No other material impact is expected.

In November 2016, the FASB issued ASU 2016-18, *Restricted Cash*, as an update to ASC 230, *Statement of Cash Flows*. This update requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. The updated guidance will be effective for annual periods beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. The new guidance should be applied on a retrospective basis. The updated guidance will result in a change in the cash flow statement to include restricted cash and restricted cash equivalents. No other material impact is expected.

In January 2017, the FASB issued ASU 2017-01, *Clarifying the Definition of a Business*, as an update to ASC 805, *Business Combinations*. This update provides a screen for determining when a set is not a business and removes the evaluation of whether a market participant could replace missing elements. The updated guidance will be effective for annual periods beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted. Amendments should be applied prospectively. The System adopted the guidance in ASU 2017-01 for fiscal year 2017, which did not have a material impact to the System's consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, *Simplifying the Test for Goodwill Impairment*, as an update to ASC 350, *Intangibles – Goodwill and Other*. This update eliminates step 2 of the goodwill impairment test which required an entity to determine the fair value of individual assets and liabilities of the reporting unit. Under this updated guidance, the impairment amount will be

3. Summary of Significant Accounting Policies (continued)

determined using the step 1 comparison of fair value to carrying value. The updated guidance will be effective for the annual and any interim goodwill impairment tests in fiscal years beginning after December 15, 2020. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The adoption of the guidance is not expected to have a material impact to the System's consolidated financial statements.

In March 2017, the FASB issued ASU 2017-07, *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. This update changes the presentation requirements of net period pension and postretirement benefit costs in the statement of operations by requiring the service cost component to be presented as part of compensation expense, and the remaining components to be presented separately from the service cost component and outside a subtotal of income from operations. The updated guidance is effective for annual periods beginning after December 15, 2017, including interim periods within those years, and is required to be applied retrospectively. Early adoption is permitted. The updated guidance will affect the classification of expense within the System's statement of operations and no other material impact is expected.

Reclassifications

Certain prior year amounts have been reclassified to conform to the current year presentation. In connection with the System's adoption of ASU 2015-03, the System reclassified $8,964,000 in deferred debt issuance costs from other assets to long term debt and $1,288,000 in debt issuance cost amortization from depreciation and amortization expense to interest expense as of and for the year ended June 30, 2016.

Performance Indicator

The performance indicator is revenues in excess of expenses, which includes all changes in unrestricted net assets other than changes in the pension liability funded status, changes in non-controlling interests, net assets released from restrictions for property acquisitions, unrealized gains and losses on certain investments held by the System's foundations and insurance captive, cumulative effect of changes in accounting principles, discontinued operations, contributions of property and equipment, and other changes not required to be included within the performance indicator under generally accepted accounting principles.

3. Summary of Significant Accounting Policies (continued)

Operating and Non-operating Activities

CHRISTUS' primary mission is to meet the health care needs in its market areas through a broad range of general and specialized health care services, including inpatient acute care, outpatient services, physician services, and other health care services. Activities directly associated with furthering this purpose are considered to be operating activities. Earnings from the investment activities of the offshore captive and community foundations are also classified as operating activities as such earnings support the operations of those organizations. Other activities that result in gains or losses peripheral to CHRISTUS' primary mission are considered to be non-operating. Non-operating activities include all other investment earnings, gains or losses from bond defeasance, and net interest cost and changes in fair value of interest rate swaps.

4. Net Patient Service Revenue

Net patient service revenue is reported at the estimated net realizable amounts from third-party payors and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Amounts subject to retroactive adjustments are estimated and recorded in the period the related services are rendered and adjusted in future periods as final settlements are determined. The estimated settlements recorded at June 30, 2017 and 2016, could differ from actual settlements. Inpatient acute care services and outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to a patient diagnosis-related group classification system that is based on clinical, diagnostic, and other factors. Inpatient and outpatient services rendered to Medicaid program beneficiaries are paid under cost reimbursement methodologies, prospectively determined rates per discharge, and prospectively determined or negotiated rates.

For fiscal years 2017 and 2016, revenue increased $24,128,000 and $26,571,000, respectively, related to changes in estimates for cost report re-openings, appeals, and tentative and final cost report settlements on filed cost reports, of which some are still subject to audit, additional re-opening, and/or appeal.

Revenue from the Medicare and Medicaid programs accounted for approximately 24% and 9%, respectively, of the System's net patient revenue for the year ended June 30, 2017, and 21% and 7%, respectively, of the System's net patient revenue for the year ended June 30, 2016. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

4. Net Patient Service Revenue (continued)

The System has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment to the System under these agreements includes prospectively determined rates per discharge, discounts from established charges, and negotiated daily rates. Revenue under the Managed Care and Commercial contracts accounted for approximately 40% and 8%, respectively, of the System's net patient revenue for the year ended June 30, 2017, and 46% and 8%, respectively, of the System's net patient revenue for the year ended June 30, 2016.

Patient service revenue, net of contractual allowances but before provision for bad debts, recognized for the years ended June 30, consisted of (dollars in thousands):

	2017 Patient Service Revenue	**% of Total**	**2016 Patient Service Revenue**	**% of Total**
Medicare	**$ 1,171,251**	**24%**	$ 755,412	21%
Medicaid	**427,939**	**9**	249,614	7
Managed care	**1,950,343**	**40**	1,648,970	46
Commercial	**390,429**	**8**	286,523	8
Self-pay and other	**904,963**	**19**	644,992	18
Total	**$ 4,844,925**	**100%**	$ 3,585,511	100%

Federal law permits state Medicaid programs to make special payments to hospitals that serve a disproportionately large number of Medicaid and low-income patients. Such hospitals are called disproportionate share hospitals and receive disproportionate share funding under the program known as DSH. These funds are different from most other Medicaid payments because they are not tied to specific services for Medicaid-eligible patients. Additionally, the federal Medicaid rules allow for hospitals to be reimbursed for some of the uncompensated cost of treating Medicaid and uninsured patients remaining after DSH payments.

4. Net Patient Service Revenue (continued)

In December 2010, the State of Louisiana adopted a Medicaid State Plan Amendment under which CHRISTUS' Louisiana hospitals, along with various other hospitals in the state, became eligible to receive DSH or upper payment limit (UPL) funding up to their individual Medicaid hospital-specific limits, as defined by federal law and as limited in the aggregate by federal law. Each year the State Department of Health and Hospitals adopts a budget designating the total amount of payments the qualifying group of hospitals will receive. Income from these supplemental programs is subject to retrospective adjustment based on state audits. As a result, there is at least a possibility that recorded estimates will change by a material amount in the near term.

In December 2011, the Centers for Medicare and Medicaid Services (CMS) approved an 1115(b) demonstration waiver program (1115(b) waiver program) submitted by the Texas Health and Human Services Commission (HHSC). The waiver program provides payments to hospitals through two pools: Uncompensated Care Pool (UC) and the Delivery System Reform Incentive Pool (DSRIP). Both pools replace the former UPL in Texas. CHRISTUS has operations in four different regional health partnerships under the 1115(b) waiver program and has approximately 41 DSRIP projects that are eligible for funding to CHRISTUS hospitals. The waiver program was scheduled to expire on September 30, 2016; however, CMS approved a 15-month extension that will end December 31, 2017. HHSC has submitted a request to CMS for a second extension that would provide funding until September 2019. The request for a second extension has not yet been approved. September 30, 2016, marked the completion of the fifth demonstration year.

HHSC provides all Texas hospitals the DSH and UC tools for each demonstration year and certain requirements must be met by the hospitals in order to qualify for either DSH or UC. The 2016 tools have been finalized by HHSC and were used by HHSC in modeling both DSH and UC payments for the fifth demonstration year ended September 30, 2016. Additionally, the 2017 DSH and UC tools have been completed and will be used in finalizing DSH and UC payments for the sixth demonstration year that ends December 31, 2017.

In fiscal years 2017 and 2016, the System recorded \$120,469,000 and \$66,312,000, respectively, in net patient service revenue related to the DSRIP program. Additionally, \$277,375,000 and \$163,410,000 was in net patient service revenue in fiscal years 2017 and 2016, respectively, related to the DSH, UC, and UPL programs.

4. Net Patient Service Revenue (continued)

Beginning in 2017, the System participated in the Network Access Improvement Program (NAIP), which is a joint federal and State of Texas Medicaid program, administered by CMS and HHSC, for Medicaid members enrolled in a managed care organization. NAIP was designed to further the State of Texas' goal of increasing the availability and effectiveness of primary care for Medicaid beneficiaries by incentivizing health-related institutions and public hospitals to provide quality, well-coordinated, continuous care. In fiscal year 2017, the System recorded $13,708,000 related to the NAIP program.

The health care industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, participation requirements of government health care programs, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Government activity has continued with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by health care providers. Violations of these laws and regulations could result in expulsion from government health care programs, together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Termination of the System's participation in the Medicare or Medicaid programs could have a material impact on the consolidated financial statements. If the 1115(b) waiver program extension is not granted or is significantly altered, it could eliminate or reduce the amounts of UC and DSRIP received by the System and could have a material impact on the financial statements.

In addition, government agencies may review the System's compliance with various payment regulations and conduct audits under CMS's Recovery Audit Contractor (RAC) as well as other programs. The RAC program has been made permanent and was required to be expanded broadly to health care providers pursuant to the Tax Relief and Health Care Act of 2006. The results of the enhanced medical necessity reviews and the RAC program audits could have an adverse effect on the System's consolidated financial statements. To the extent these reviews result in an adverse finding, the System may appeal the adverse finding, though it may incur significant legal expense.

5. Cash and Investments

Total cash and investments for the System at June 30, including assets whose use is limited, are as follows (in thousands):

	2017	2016
Cash and cash equivalents	**$ 710,707**	$ 643,993
Certificates of deposit	**30,304**	20,822
Domestic equities	**79,165**	89,967
International equities	**20,873**	24,288
Fixed-income securities	**118,663**	119,822
U.S. government securities	**270,565**	191,465
Mutual funds and exchange-traded funds:		
Domestic equity funds	**49,599**	156,686
International equity funds	**36,847**	76,331
Fixed-income funds	**161,610**	296,408
Risk parity, blended and other funds	**16,016**	10,936
Equity in managed funds:		
Fixed-income funds	**165,472**	133,343
Hedge funds	**213,112**	260,444
Private equity, real estate, and other	**10,643**	7,121
	$ 1,883,575	$ 2,031,626

The System's investments are subject to various types of risks, as explained below.

Fixed Income

This investment class includes investments in various fixed-income instruments that include investment-grade and high-yield domestic and international bonds, preferred stocks, mortgage pools, master limited partnership units, and bonds issued by U.S. government agencies. The fixed-income investments are exposed to various kinds and levels of risk, including interest rate risk, credit risk, foreign exchange risk, and liquidity risk.

5. Cash and Investments (continued)

Equities

This investment class consists primarily of common and preferred equity securities of domestic and foreign companies. These securities trade through the major public domestic and international exchanges. The equity securities investments are exposed to various risks, including market risk, individual security risk, foreign exchange risk, and, for common equity of companies with a small market capitalization, liquidity risk.

Mutual Funds and Exchange-traded Funds

This investment class includes investments in mutual funds, exchange-traded funds, common collective trust funds, and other similar investment funds that generally hold investments in marketable debt and equity securities. Investments in mutual funds, exchange-traded funds, common collective trust funds, and similar funds in this category are exposed to various risks, including market risk and risks associated with the specific securities held within the funds. Certain funds within this category are valued based on amounts reported to the System by the fund managers, generally in the form of net asset value per share (NAV) or an equivalent measure.

Equity Investments in Managed Funds

Equity investments in managed funds include investments in limited liability partnerships or corporations and other alternative investments. The System's equity investments in managed funds are recorded based on the System's share of the underlying value of marketable securities and non-marketable interests held by these funds as reported to the System by the fund managers, generally in the form of NAV or an equivalent measure. These investments are recorded at amounts confirmed by fund managers, and there can be no assurance such reported amounts will ultimately be realized.

5. Cash and Investments (continued)

These funds are invested with external investment managers who invest primarily in various categories, including fixed income, long and short equity positions, managed futures, emerging markets, distressed enterprises, arbitrage, risk parity, private equity, and real estate positions.

These investments are domestic and international in nature, are illiquid, and may not be realized for a period of several years after the investments are made. The risks associated with these investments are numerous, resulting in a greater likelihood of losing invested capital. The risks include the following:

Non-Regulation Risk – Some of these funds are not required to register with the Securities and Exchange Commission (SEC) and are not subject to regulatory controls.

Managerial Risk – Fund managers may fail to produce the intended returns and are not subject to oversight.

Minimal Liquidity – Many funds impose lock-up periods that prevent investors from redeeming their shares or impose penalties to redeem.

Limited Transparency – As unregistered investment vehicles, funds are not required to disclose the holdings in their portfolios to investors.

Investment Strategy Risk – The funds often employ sophisticated, risky investment strategies, are speculative, and may use leverage, which could result in volatile returns.

At June 30, 2017 and 2016, the System had commitments to fund equity investments in private equity funds totaling $5,590,000 and $6,581,000, respectively, excluding commitments to fund equity investments in private equity funds held by the CHRISTUS Cash Balance Plan (see Note 11).

5. Cash and Investments (continued)

Assets whose use is limited or restricted consisted of the following at June 30 (in thousands):

	2017	2016
Assets whose use is limited or restricted, required for current bond indenture and self-insurance liabilities	**$ 58,831**	$ 58,387
Other investments, internally designated for capital expansion and other purposes	**313,468**	542,228
Under bond indenture agreement – held by trustee	**59,332**	68,966
Under liability retention and self-insurance funding arrangement – held by trustee	**19,129**	31,076
Under Emerald Assurance funding arrangements	**222,633**	183,187
Restricted cash and investments	**95,363**	43,628
Total assets whose use is limited or restricted	**$ 768,756**	$ 927,472

Investment returns and gains and (losses) for assets limited as to use, cash equivalents, and other unrestricted investments consisted of the following for the years ended June 30 (in thousands):

	2017	2016
Operating interest and dividend income	**$ 9,932**	$ 5,658
Operating gain, realized and unrealized	**4,292**	2,562
Equity investment gain (loss) on managed funds	**3,264**	(2,767)
Total operating investment income	**17,488**	5,453
Non-operating interest and dividend income	**10,312**	10,525
Non-operating gain, realized and unrealized	**35,875**	7,041
Equity investment gain (loss) on managed funds	**10,327**	(16,101)
Net swap agreement activity	**38,874**	(73,038)
Total non-operating investment gain (loss)	**95,388**	(71,573)
Total investment gain (loss)	**$ 112,876**	$ (66,120)

6. Fair Value Measurements

The three-level valuation hierarchy for disclosure of fair value measurements is based on the transparency of inputs to the valuation of an asset or liability as of the reporting date. The three levels are defined as follows:

- Level 1 – Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities at the reporting date.

- Level 2 – Inputs to the valuation methodology other than quoted market prices included in Level 1 that are observable for the asset or liability. Level 2 pricing inputs include quoted prices for similar assets and liabilities in active markets and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

- Level 3 – Inputs that are generally unobservable and typically reflect management's estimate of assumptions that market participants would use in pricing the asset or liability.

A financial instrument's categorization within the valuation hierarchy is based on the lowest level of input that is significant to the fair value measurement. There were no significant transfers between levels during the years ended June 30, 2017 and 2016.

6. Fair Value Measurements (continued)

The following tables present the financial instruments carried at fair value as of June 30 (in thousands) by the valuation hierarchy (as described above):

	2017			
	Level 1	**Level 2**	**Level 3**	**Total**
Assets				
Investments:				
Cash and cash equivalents	**$ 710,707**	**$ –**	**$ –**	**$ 710,707**
Certificates of deposit	**–**	**30,304**	**–**	**30,304**
Domestic equities	**79,165**	**–**	**–**	**79,165**
International equities	**20,873**	**–**	**–**	**20,873**
Fixed-income securities	**–**	**118,663**	**–**	**118,663**
U.S. government securities	**–**	**270,565**	**–**	**270,565**
Mutual and exchange-traded funds:				
Domestic equity funds	**35,560**	**–**	**–**	**35,560**
International equity funds	**36,847**	**–**	**–**	**36,847**
Fixed income funds	**86,745**	**–**	**–**	**86,745**
Risk parity, blended and other funds	**16,016**	**–**	**–**	**16,016**
	$ 985,913	**$ 419,532**	**$ –**	**$ 1,405,445**
Investments measured at net asset value or equivalent:				
Equity funds				**14,039**
Fixed-income funds				**109,758**
Hedge funds				**49,667**
Private equity, real estate and other funds				**10,643**
Total assets at fair value				**$ 1,589,552**
Liabilities				
Interest rate swap agreements	**$ –**	**$ 116,160**	**$ –**	**$ 116,160**
Total liabilities at fair value	**$ –**	**$ 116,160**	**$ –**	**$ 116,160**

6. Fair Value Measurements (continued)

During the year ended June 30, 2017, long-lived assets held and used with a carrying amount of $35,371,000 were written down to their fair value of $24,615,000, resulting in an impairment charge of $10,756,000. Fair value was estimated primarily using an internally developed discounted cash flow income approach, a Level 3 input.

	2016			
	Level 1	**Level 2**	**Level 3**	**Total**
Assets				
Investments:				
Cash and cash equivalents	$ 643,993	$ –	$ –	$ 643,993
Certificates of deposit	–	20,822	–	20,822
Domestic equities	89,967	–	–	89,967
International equities	24,288	–	–	24,288
Fixed-income securities	–	119,822	–	119,822
U.S. government securities	–	191,465	–	191,465
Mutual and exchange-traded funds:				
Domestic equity funds	144,780	–	–	144,780
International equity funds	76,331	–	–	76,331
Fixed income funds	203,614	–	–	203,614
Risk parity, blended and other funds	10,936	–	–	10,936
	$ 1,193,909	$ 332,109	$ –	$ 1,526,018
Investments measured at net asset value or equivalent:				
Equity funds				11,906
Fixed-income funds				120,938
Hedge funds				52,714
Private equity, real estate and other funds				7,121
Total assets at fair value				$ 1,718,697
Liabilities				
Interest rate swap agreements	$ –	$ 168,520	$ –	$ 168,520
Total liabilities at fair value	$ –	$ 168,520	$ –	$ 168,520

6. Fair Value Measurements (continued)

The tables above include equity investments in managed funds held within the System's foundations and captive insurer. Remaining equity investments in managed funds held by other System entities of $294,023,000 and $312,929,000 at June 30, 2017 and 2016, respectively, are not included in this table since they are accounted for using the equity method of accounting.

The valuation methodologies used for instruments measured at fair value as presented in the tables above are as follows:

- *Investments* – Investments valued at quoted prices available in an active market are classified within Level 1 of the valuation hierarchy. Investments valued based on evaluated bid prices provided by third-party pricing services, where quoted market prices are not available, are classified within Level 2 of the valuation hierarchy. Investments measured at fair value using net asset value per share or its equivalent as a practical expedient are not categorized within the fair value hierarchy. These investments consist of hedge funds, commodity funds, common collective trust funds, private equity funds, and real estate funds.

- *Interest rate swap agreements* – Interest rate swap agreements are valued using third-party models that use observable market conditions as their input and are classified within Level 2 of the valuation hierarchy.

At June 30, 2017 and 2016, the System's financial instruments included cash and cash equivalents, accounts receivable, assets limited as to use, accounts payable and accrued expenses, estimated third-party payor settlements, and long-term debt. The carrying amounts reported in the consolidated balance sheets for these financial instruments, except for long-term debt, approximate their fair values due to their short-term nature.

The System's fixed-rate debt is enhanced with bond insurance. The estimated fair value of the fixed-rate debt, if it were not enhanced by insurance, is $508,458,000 compared to its carrying value of $484,915,000 at June 30, 2017. This fair value is based on a combination of quoted market prices for identical securities when available, a Level 1 input, and quoted market prices for similarly rated health care revenue bond issues, a Level 2 input.

6. Fair Value Measurements (continued)

At June 30, 2017, the System has several issues of variable-rate demand bonds outstanding. The System's continued participation in these debt programs depends on its ability to extend or replace the existing credit facilities supporting the respective standby purchase agreements. If these credit facilities are not available, the System will likely refund these outstanding series with available funds or funds derived from fixed-rate series proceeds. It is not practicable to estimate the fair value of the variable-rate demand bonds separate from the value supported by the credit facilities.

7. Property and Equipment

Property and equipment at June 30 consisted of the following (in thousands):

	2017	2016
Land	**$ 197,080**	$ 199,456
Land improvements	**83,512**	70,457
Buildings and fixed equipment	**2,903,194**	2,513,418
Major movable equipment	**1,701,737**	1,612,874
Accumulated depreciation	**(2,735,811)**	(2,598,356)
	2,149,712	1,797,849
Construction-in-progress (estimated cost to complete is $439,000 and $425,000 at June 30, 2017 and 2016, respectively)	**208,964**	142,334
Total	**$ 2,358,676**	$ 1,940,183

Depreciation expense for the System for fiscal years 2017 and 2016 totaled $211,440,000 and $195,655,000, respectively. The total includes impairment losses of $10,756,000 and $31,117,000 in fiscal years 2017 and 2016, respectively.

Assets capitalized under capital leases as reflected in the accompanying consolidated balance sheets were $77,732,000 of buildings and fixed equipment and $49,406,000 of major moveable equipment as of June 30, 2017 and $35,902,000 of buildings and fixed equipment and $23,162,000 of major moveable equipment as of June 30, 2016. The accumulated depreciation related to assets under capital leases was $57,199,000 and $51,102,000 as of June 30, 2017 and 2016, respectively. Depreciation of assets under capital leases is included in depreciation expense.

8. Investments in Unconsolidated Organizations

The System has investments in unconsolidated organizations of $150,823,000 and $148,095,000 at June 30, 2017 and 2016, respectively. Differences between the carrying amounts of the System's investments and the underlying equity in the net assets of the investees total $56,044,000 and $51,692,000 at June 30, 2017 and 2016, respectively, which relates primarily to equity method goodwill. The following investments account for 91% and 90% of the System's total investments in unconsolidated organizations in fiscal years 2017 and 2016, respectively:

Salud U.C. SpA

On January 31, 2014, CHRISTUS Chile SpA, a wholly-owned Chilean corporation, obtained a 40% non-controlling interest through the purchase of shares of Salud U.C. SpA (Salud U.C.) from Pontifica Universidad Catolica de Chile (PUC) for cash consideration of $20,878,000. As part of the reorganization described more fully in Note 18, PUC refunded $10,000,000 of the purchase price in 2016. During 2017 and 2016, CHRISTUS made additional capital contributions of $2,838,000 and $836,000, respectively. CHRISTUS' recorded investment, accounted for under the equity method, was $13,278,000 and $10,725,000 at June 30, 2017 and 2016, respectively. The System's share of losses for the years ended June 30, 2017 and 2016, was $285,000 and $220,000, respectively. Note 18 has additional discussion of the System's international operations.

Inversiones San Carlos, SpA

In May 2014, CHRISTUS Chile Limitada, a wholly-owned Chilean subsidiary of CHRISTUS Chile, SpA, purchased 100% of the shares of Inversiones San Carlos, SpA, a Chilean corporation, from Colmena Salud S.A. for cash consideration of $68,000,000. Inversiones San Carlos, SpA owns 50% interest in Servicios Clinicos San Carlos de Apoguindo S.A. and Immobiliaria Clinica San Carlos de Apoguindo S.A. (jointly referred to as "San Carlos"). During 2017, CHRISTUS made an additional investment of $14,560,000. The System's recorded investment, accounted for under the equity method, was $82,114,000 and $68,159,000 at June 30, 2017 and 2016, respectively. The System's share of losses for the years ended June 30, 2017 and 2016, was $605,000 and $95,000, respectively. Note 18 has additional discussion of the System's international operations.

8. Investments in Unconsolidated Organizations (continued)

Coomeva Cooperativa Medica

Effective June 14, 2016, CHRISTUS signed definitive agreements with Cooperativa Medica del Valle y de Profesionales de Colombia (Coomeva) in Colombia. In September 2016, CHRISTUS closed on various transactions outlined in the definitive agreements and paid $22,198,000 to obtain a non-controlling ownership interest in various Coomeva companies. In March 2017, CHRISTUS paid an additional $5,087,000 to increase its ownership interest in these companies. At June 30, 2017, CHRISTUS owns a 31.25% equity interest in and management of Sinergia Global en Salud SAS (Sinergia), a health care provider network including two hospitals, the largest home care company in the country and ambulatory facilities in nearly every community in Colombia. CHRISTUS also owns a 10% equity interest in Coomeva Medicina Prepagada (MP), a private health insurance company that contracts with individuals and employers to provide private health insurance nationwide.

The System's investment in Sinergia is accounted for under the equity method of accounting because CHRISTUS can exercise significant influence over the operations of Sinergia. The System's investment in MP is accounted for under the cost method because CHRISTUS does not exercise significant influence over MP's operations. The System's total investment was $26,872,000 at June 30, 2017. The System recorded its share of loss from the operations of Sinergia during the year ended June 30, 2017 of $413,000. Dividends of $257,000 were declared by MP and recorded as other revenue during the year ended June 30, 2017.

HealthSouth Rehabilitation Hospital

CHRISTUS Trinity Mother Frances Health System owns 50% of HealthSouth Rehabilitation Hospital – Tyler d/b/a/ Trinity Mother Frances Rehabilitation Hospital (HealthSouth). Because CHRISTUS can exercise significant influence over the operations of HealthSouth, but does not control HealthSouth, this investment is accounted for using the equity method of accounting. The System's recorded investment was $7,803,000 and $4,260,000 at June 30, 2017 and June 30, 2016, respectively. The System recorded its share of income from operations during the years ended June 30, 2017 and 2016 of $3,627,000 and $0, respectively.

8. Investments in Unconsolidated Organizations (continued)

CS/USP Surgery Centers, L.P.

CHRISTUS Spohn Health System Corporation has a 50% ownership interest in a Texas limited liability partnership with United Surgical Partners International, Inc. for the purpose of owning and operating ambulatory surgery centers in Corpus Christi, Texas. The venture consists of two surgery centers near the campus of Spohn Shoreline, Corpus Christi Outpatient Surgery and SurgiCare, and one endoscopy center. CHRISTUS' recorded investment, accounted for under the equity method, was $7,064,000 and $6,798,000 at June 30, 2017 and 2016, respectively. The System recorded its share of income from operations in fiscal years 2016 and 2015 of $1,080,000 and $967,000, respectively.

Houston Methodist St. John Hospital and Houston Methodist St. Catherine Real Property Company

On February 1, 2014, CHRISTUS Gulf Coast sold a controlling interest of 70% of CHRISTUS St. John Hospital to Methodist Health Centers. Methodist Health Centers operates Houston Methodist St. John Hospital in which CHRISTUS Gulf Coast maintained a 30% non-controlling interest. The System's recorded investment, accounted for under the equity method, was $29,007,000 at June 30, 2016. The System's share of loss was $(608,000) for the year ended June 30, 2016.

On January 31, 2014, CHRISTUS Gulf Coast contributed the land, building, and improvements of CHRISTUS Health St. Catherine Hospital to Houston Methodist St. Catherine Real Property Company (HMSCRE), a Texas nonprofit corporation. Under the membership agreement, CHRISTUS Gulf Coast retained a 30% non-controlling membership interest in HMSCRE. The System's recorded investment, accounted for under the equity method, was $14,040,000 at June 30, 2016. The System's share of income from operations was de minimis for the year ended June 30, 2016.

In July 2016, CHRISTUS Gulf Coast sold its remaining 30% interest in Houston Methodist St. John Hospital and its remaining 30% interest in Houston Methodist St. Catherine Real Property Company to Methodist Health Centers for $43,140,000, of which $21,570,000 was received in cash, and a one-year note with a 0.4% interest rate was signed for the remaining $21,570,000. This note, and related accrued interest, is classified as notes and other receivables on the accompanying consolidated balance sheet as of June 30, 2017. The note and accrued interest was paid in full in July 2017. At June 30, 2017, the System has no remaining investment in Houston Methodist St. John Hospital or Houston Methodist St. Catherine Real Property Company.

8. Investments in Unconsolidated Organizations (continued)

CHRISTUS Health and its affiliates hold immaterial investments in other unconsolidated subsidiaries. No other single investment balance exceeded $5,000,000 at both June 30, 2017 and 2016.

9. Long-Term Debt

Long-term debt at June 30 consisted of the following (in thousands):

	2017	2016
Obligations issued under the CHRISTUS Health Master Trust Indenture:		
Revenue bonds, in variable-rate demand mode, with weighted average interest rates of 0.69% and 0.14% in fiscal years 2017 and 2016, respectively, due in annual installments through July 1, 2047 (Series 2008C and 2009B)	$ 225,885	$ 225,885
Revenue bonds, in auction mode, with weighted average interest rates of 0.87% and 0.47% in fiscal years 2017 and 2016, respectively, due in annual installments through July 1, 2031	156,575	165,500
Revenue bonds, in fixed-rate mode, bearing interest from 4.50% to 6.50%, due in annual installments through July 1, 2035	338,210	374,820
Direct-placement notes due in annual installments through July 1, 2041	117,199	–
Tax exempt bank note due in annual installments through July 1, 2039	57,105	–
Obligations issued under the Mother Frances Hospital Regional Health Care Center Master Trust Indenture:		
Revenue bonds, in fixed-rate mode, bearing interest from 4.50% to 5.60%, due in annual installments through July 1, 2037	–	138,795
Direct-placement note due in annual installments through July 1, 2022	–	42,467
Bank note due in monthly installments through April 1, 2029	–	7,539
Obligations issued under The Good Shepherd Hospital, Inc. Master Trust Indenture:		
Revenue bonds, in fixed-rate mode, bearing interest from 3.82% to 5.25%, due in annual installments through July 1, 2042	61,810	–
Direct-placement note due in annual installments through October 1, 2029	69,200	–
Other notes and capital lease obligations	160,082	79,732
	1,186,066	1,034,738
(Discounts) and premiums on long-term debt	(15,345)	759
Unamortized deferred financing costs	(8,716)	(8,964)
	1,162,005	1,026,533
Less current portion	(44,880)	(55,815)
Total	$ 1,117,125	$ 970,718

9. Long-Term Debt (continued)

According to the terms of the CHRISTUS Health Master Trust Indenture (CHRISTUS MTI), the Obligated Group consists of CHRISTUS and the following eight entities: CHRISTUS Spohn Health System, CHRISTUS Health Southeast Texas, CHRISTUS Santa Rosa Health Care Corporation, CHRISTUS Health Ark-La-Tex, CHRISTUS Health Northern Louisiana, CHRISTUS Health Central Louisiana, CHRISTUS Health Southwestern Louisiana, and effective October 3, 2016 Mother Frances Hospital Regional Healthcare Center.

Certain entities of CHRISTUS that are otherwise included in the consolidated financial statements of CHRISTUS are excluded from the CHRISTUS Health Obligated Group. These entities include, but are not limited to, the CHRISTUS Good Shepherd Health System entities; CHRISTUS Hopkins Health Alliance; CHRISTUS Trinity Mother Frances Health System; CHRISTUS Health Liability Retention Trust; Emerald Assurance; CHRISTUS St. Vincent Regional Medical Center; CHRISTUS Physician Group; CHRISTUS Continuing Care; CHRISTUS Health Gulf Coast (effective October 3, 2016); CHRISTUS Muguerza, S.A. de C.V.; CHRISTUS Health Strategic Growth; Amatista Financing Company, Ltd.; CHRISTUS Health Latin America; CHRISTUS Health Chile SpA; and various partnerships and philanthropic foundations.

Under the provisions of the CHRISTUS MTI, the obligations of CHRISTUS and the other members of the Obligated Group are secured by a pledge of gross revenues. Additionally, each member of the Obligated Group has undertaken certain covenants, including the following: to ensure the payment of debt service; to ensure the payment of taxes and other claims; to deliver compliance statement(s); to preserve corporate existence; to maintain books and records subject to inspection by the Master Trustee; to maintain insurance; to conform to defined lien limitations; to establish adequate service rates; to maintain a sufficient debt service coverage and indebtedness ratio; to maintain a required aggregate amount of unrestricted cash and investments; and to adhere to certain defined conditions with respect to consolidation, merger, conveyance, or transfer, and admission or withdrawal of Obligated Group members pursuant to the CHRISTUS MTI, insurer, and letter of credit bank agreements.

Certain debt obligations of CHRISTUS Good Shepherd Health System are subject to the terms of The Good Shepherd Hospital, Inc. Master Trust Indenture (GSH MTI). According to the GSH MTI, The Good Shepherd Hospital, Inc. d/b/a CHRISTUS Good Shepherd Medical Center-Longview; Good Shepherd Health System, Inc. d/b/a CHRISTUS Good Shepherd Health System; and Harrison County Hospital Association d/b/a CHRISTUS Good Shepherd Medical Center-Marshall are the members of the Obligated Group. The GSH MTI and loan agreements require

9. Long-Term Debt (continued)

that certain funds be established with a trustee, and that members of the Obligated Group comply with certain covenants, including maintaining sufficient debt service coverage, restrictions on incurrence of additional debt, and restrictions on the disposition of assets or transfers of assets out of the Obligated Group. In connection with the acquisition of CHRISTUS Good Shepherd Health System in February 2017, Good Shepherd Health System obtained a waiver of certain covenants and requirements, including the rate covenant through September 30, 2018 and the timely filing of financial statements for the fiscal year ending September 30, 2016.

CHRISTUS has letter of credit bank agreements on Series 2008C and 2009B variable-rate demand bonds. The Series 2008C-1 bonds have an outstanding amount of $41,435,000 and are supported by a letter of credit provided by Sumitomo Mitsui Banking Corporation, acting through its New York branch, that expires on September 21, 2020. The 2008C-2 bonds have an outstanding amount of $38,305,000 and are supported by a letter of credit provided by The Bank of New York Mellon that expires on June 23, 2021. The 2008C-3 bonds have an outstanding amount of $43,900,000, and the 2008C-4 bonds have an outstanding amount of $38,440,000. The 2008C-3 and 2008C-4 bonds are supported by a letter of credit provided by Bank of Montreal, acting through its Chicago branch, that expires on April 25, 2020. The Series 2009B variable-rate demand bonds have an outstanding amount of $63,805,000 and are supported by a letter of credit provided by The Bank of New York Mellon that expires on July 31, 2018.

In October, 2016, CHRISTUS executed an acquisition financing transaction for certain health facilities of the Mother Frances Hospital Regional Health Care Center in the amount of $174,304,000, which consisted of $59,560,000 as a private placement of bonds with a final maturity date of July 1, 2034 (Series 2016A); $25,335,000 as private placement of bonds with a final maturity date of July 1, 2020 (Series 2016B); $10,864,000 as a private placement of bonds with a final maturity date of July 1, 2022 (Series 2016C); $21,440,000 as a private placement of bonds with a final maturity date of July 1, 2041 (Series 2016D); and $57,105,000 as a tax-exempt loan with a final maturity date of July 1, 2039 (Series 2016E). Proceeds of the debt were used to repay certain obligations of the Mother Frances Hospital Regional Health Care Center. On the date of issuance of the debt, the Mother Frances Hospital Regional Health Care Center Master Trust Indenture and all debt secured thereunder was discharged.

9. Long-Term Debt (continued)

In February 2017, Good Shepherd Health System Obligated Group issued $69,200,000 of private placement bond debt with a final maturity date of October 1, 2029 (Series 2017A). The issue was used to refund the outstanding Good Shepherd Health System Obligated Group's 2015A bonds. The Series 2017A bonds are guaranteed by CHRISTUS Health Strategic Growth, which is not a member of the CHRISTUS Health Obligated Group.

In June 2017, CHRISTUS entered into a transaction to legally cash defease outstanding municipal debt related to its Series 2005A bonds totaling $7,125,000 by establishing an irrevocable escrow account to fund the debt service until the applicable maturity or redemption dates. The defeased debt has been accounted for as if it were extinguished at June 30, 2017.

Other notes and capital lease obligations were $160,082,000 and $79,732,000 as of June 30, 2017 and 2016, respectively. Other notes account for $47,952,000 and $30,182,000 of that balance as of June 30, 2017 and 2016, respectively, and were comprised of various notes issued primarily to purchase equipment. Capital lease obligations account for $112,130,000 and $49,550,000 of that balance as of June 30, 2017 and 2016, respectively, and are comprised of various building and equipment leases. In fiscal 2017, the System entered into new capital lease commitments for buildings at CHRISTUS Hopkins Health Alliance and Trinity Mother Frances for approximately $42,000,000 and $22,000,000, respectively.

Principal payments for all long-term debt for the next five years and thereafter are as follows (in thousands):

2018	$ 44,880
2019	48,487
2020	71,410
2021	51,633
2022	47,387
Thereafter	922,883
Total debt	$ 1,186,680

10. Derivative Financial Instruments

Interest rate swap contracts between the System and third parties (counterparties) provide for the periodic exchange of payments between the parties based on changes in a defined index and a fixed rate. These swaps expose the System to market risk and credit risk. Credit risk is the risk that contractual obligations of the counterparties will not be fulfilled. Concentrations of credit risk relate to groups of counterparties that have similar economic or industry characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions. Counterparty credit risk is managed by requiring high credit standards for the System's counterparties. The counterparties to these contracts are financial institutions that carry investment-grade credit ratings.

Market risk is the adverse effect on the value of a financial instrument that results from a change in interest rates. The market risk associated with interest rate changes is managed by establishing and monitoring parameters that limit the types and degrees of market risk that may be undertaken. Management also mitigates risk through periodic reviews of their derivative positions in the context of their blended cost of capital. As of June 2017 and 2016, CHRISTUS has interest rate swap agreements to manage interest rate risk exposure, not designated as hedging instruments, with a total notional amount of $921,035,000 and $929,685,000, respectively.

The following tables summarize the fair value at June 30, 2017 and 2016, and the income (loss) recorded related to the interest rate swap agreements as of and for the years ended June 30, 2017 and 2016, (in thousands).

Counterparty	Description	Termination Date	Interest Rate Agreements	Notional Amount	Fair Value June 30, 2017	Fair Value June 30, 2016	Change in Fair Value June 30, 2017	Change in Fair Value June 30, 2016	(Paid) Received June 30, 2017	(Paid) Received June 30, 2016
Merrill Lynch	Var. basis	2021-2023	6	$ 470,000	**$ (420)**	$ (1,380)	**$ 960**	$ (3,119)	**$ (581)**	$ 640
Wells Fargo	Fixed payer	2031	1	171,775/180,425	**(20,671)**	(32,150)	**11,479**	(7,739)	**(4,664)**	(5,378)
Citigroup*	Fixed payor	2047	2	166,100	**(56,818)**	(80,558)	**23,740**	(28,788)	**(4,924)**	(5,347)
Citigroup*	Fixed payor	2047	1	113,160	**(38,251)**	(54,432)	**16,181**	(19,702)	**(3,316)**	(3,604)
			10	$ 921,035/929,685	**$ (116,160)**	$ (168,520)	**$ 52,360**	$ (59,348)	**$ (13,485)**	$ (13,689)

*Insured by MBIA

CHRISTUS is required to post collateral for negative valuations on each of its swaps according to the terms of (1) the swap insurance agreements, where applicable and (2) the agreement with each counterparty. CHRISTUS has complied with this requirement. At June 30, 2017 and 2016, no collateral was posted. The System does not anticipate non-performance by its counterparties.

10. Derivative Financial Instruments (continued)

The fair value of these swap agreements was a liability of $116,160,000 and $168,520,000 at June 30, 2017, and June 30, 2016, respectively. The change in value of $52,360,000 and ($59,348,000) for the years ended June 30, 2017 and 2016, respectively, is combined with the payments, net of receipts, made under the agreements, of $13,485,000 and $13,690,000 for the years ended June 30, 2017 and 2016, respectively. This total is included in non-operating investment gain (loss) in the consolidated statements of operations and changes in net assets.

11. Employee Benefit Plans

Defined Benefit Plans

Cash Balance Plan

The System has established a non-contributory, defined benefit retirement plan that operates as a cash balance plan and covers substantially all CHRISTUS employees who had met age and service requirements as of December 31, 2012. On October 23, 2012, the CHRISTUS board approved the closing of the plan to new participants, effective January 1, 2013.

The plan benefits are calculated based on a cash balance formula wherein participants earn an annual accrual based on compensation and participation account balances accrue interest at a rate that tracks ten-year treasury notes; the maximum rate is 8%.

Mother Frances Hospital Defined Benefit Pension Plan

In connection with the acquisition of Trinity Mother Frances Health System, effective May 1, 2016 (see Note 19), the System acquired the assets and obligations of the Mother Frances Hospital Defined Benefit Pension Plan (TMF Plan). The TMF Plan covers all employees who meet the eligibility requirements. The plan was frozen as of December 31, 2009.

11. Employee Benefit Plans (continued)

The measurement date for the cash balance plan and the TMF Plan (collectively, the Defined Benefit Plans) is June 30. Components of net periodic benefit cost, recorded as a component of employee compensation and benefits, for the years ended June 30, consisted of the following (in thousands):

	Cash Balance Plan		TMF Plan	
	2017	**2016**	**2017**	**2016**
Service cost	**$ 16,648**	$ 18,682	**$ –**	$ –
Interest cost	**24,551**	38,174	**7,190**	1,471
Expected return on assets	**(47,128)**	(49,903)	**(7,663)**	(1,208)
Amortization of prior service credit	**(11,884)**	(11,884)	**–**	–
Recognized net actuarial loss	**22,433**	13,180	**–**	–
Net benefit cost	**$ 4,620**	$ 8,249	**$ (473)**	$ 263

CHRISTUS has historically used a single weighted average discount rate derived from the yield curve used to determine its pension benefit obligations to calculate the interest cost and service cost components of net periodic benefit costs for the Defined Benefit Plans. For 2017 and going forward, CHRISTUS has changed the method used to estimate the service cost and interest cost components of net periodic pension cost to use a full yield curve “spot rate” approach that applies the specific spot rates along the yield curve to the plans' projected cash flows. CHRISTUS has determined that using a full yield curve approach is preferable because it provides a more direct matching between the individual cash flows and the discount rates applied to those cash flows. As a result of this change, service and interest costs decreased, and operating income and revenues in excess of expenses increased, by approximately $9,400,000 for the year ended June 30, 2017.

11. Employee Benefit Plans (continued)

The following table sets forth the changes in benefit obligation, changes in plan assets, and funded status of the Defined Benefit Plans measured as of June 30 (in thousands):

	Cash Balance Plan		TMF Plan	
	2017	**2016**	**2017**	**2016**
Changes in benefit obligation				
Benefit obligation – beginning of year	**$ 927,737**	$ 898,533	**$ 229,445**	$ –
TMF benefit obligation acquired	**–**	–	**–**	221,077
Service cost	**16,648**	18,682	**–**	–
Interest cost	**24,551**	38,174	**7,190**	1,471
Actuarial loss (gain)	**22,719**	18,768	**(6,406)**	7,784
Benefits paid	**(45,021)**	(46,420)	**(5,614)**	(887)
Benefit obligation – end of year	**$ 946,634**	$ 927,737	**$ 224,615**	$ 229,445

11. Employee Benefit Plans (continued)

	Cash Balance Plan		TMF Plan	
	2017	**2016**	**2017**	**2016**
Changes in plan assets				
Fair value of plan assets – beginning of year	**$ 804,569**	$ 850,190	**$ 144,774**	$ –
TMF Plan assets acquired	**–**	–	**–**	140,847
Actual return on plan assets	**66,309**	(12,201)	**14,868**	3,314
Employer contributions	**13,500**	13,000	**9,000**	1,500
Benefits paid	**(45,021)**	(46,420)	**(5,614)**	(887)
Fair value of plan assets – end of year	**$ 839,357**	$ 804,569	**$ 163,028**	$ 144,774
Funded status	**$ (107,277)**	$ (123,168)	**$ (61,587)**	$ (84,671)
Amounts recognized in unrestricted net assets:				
Unrecognized net actuarial loss (gain)	**$ 230,908**	$ 249,803	**$ (7,933)**	$ 5,678
Unrecognized prior service credit	**(23,793)**	(35,677)	**–**	–
Total recognized in unrestricted net assets	**$ 207,115**	$ 214,126	**$ (7,933)**	$ 5,678

Amounts recognized in unrestricted net assets expected to be recognized in net periodic benefit cost for the Defined Benefit Plans during fiscal 2018 are $7,580,000.

The following table represents the changes to the Defined Benefit Plans' assets and projected benefit obligation recognized in unrestricted net assets for the years ended June 30 (in thousands):

	Cash Balance Plan		TMF Plan	
	2017	**2016**	**2017**	**2016**
Net actuarial loss (gain)	**$ 3,537**	$ 80,871	**$ (13,611)**	$ 5,678
Amortization of net actuarial loss	**(22,433)**	(13,180)	**–**	–
Amortization of prior service credit	**11,884**	11,884	**–**	–
Total changes recognized in unrestricted net assets	**$ (7,012)**	$ 79,575	**$ (13,611)**	$ 5,678

11. Employee Benefit Plans (continued)

As of June 30, 2017 and 2016, the Defined Benefit Plans had accumulated benefit obligations of $1,167,877,000 and $1,152,168,000, respectively. Assumptions used to determine benefit obligations and net periodic benefit cost for the fiscal years were as follows:

	Cash Balance Plan		**TMF Plan**	
	2017	**2016**	**2017**	**2016**
Benefit obligations:				
Discount rate	**3.78%**	3.54%	**3.97%**	3.85%
Rate of compensation increase	**3.71**	3.71	**N/A**	N/A
Net periodic benefit cost:				
Discount rate	**3.54**	4.37	**3.85**	4.07
Expected long-term return on plan assets	**6.00**	6.00	**5.25**	5.25
Rate of compensation increase	**3.71**	3.71	**N/A**	N/A

Investment Policy and Asset Allocations

CHRISTUS Health Cash Balance Plan

The investment objective with regard to the plan assets is one of long-term capital appreciation and generation of a stream of current income. This balanced approach is expected to earn long-term total returns, consisting of capital appreciation and current income, which are commensurate with the expected rate of return used by the plans.

The investment policies and strategies for the assets of the cash balance plan incorporate a well-diversified approach that is expected to generate long-term returns from capital appreciation and a growing stream of current income. This approach recognizes that assets are exposed to risk and the market value of the plan assets may fluctuate from year to year. Risk tolerance is determined based on the plan’s financial stability and the ability to withstand return volatility. In developing the expected return on plan assets, the System evaluates the historical performance of total plan assets, the relative weighting of plan assets, interest rates, economic indicators, and industry forecasts. In line with the investment return objective and risk parameters, the mix of assets includes a diversified portfolio of equity, fixed income, and alternative investments. Equity investments include international stocks and a blend of domestic growth and value stocks of various sizes of capitalization. The aggregate asset allocation is rebalanced as needed, but not less than on an annual basis.

11. Employee Benefit Plans (continued)

The asset allocations for the cash balance plan at June 30, by asset category, are detailed below (in thousands).

	2017	2016
Cash and cash equivalents	**$ 94,427**	$ 29,056
Domestic equities	**44,209**	37,183
International equities	**22,346**	23,845
Mutual funds and exchange-traded funds:		
Domestic equity funds	**35,341**	39,169
International equity funds	**45,414**	40,081
Fixed-income funds	**63,907**	62,840
Equity investments in managed funds:		
Fixed-income funds	**312,916**	301,671
Hedge funds	**77,892**	134,441
Private equity, real estate, and other	**142,586**	135,068
Other	**319**	1,215
Total	**$ 839,357**	$ 804,569

The target allocation of plan assets by asset category for the cash balance plan is as follows as of June 30:

	2017	2016
Allocation of plan assets by asset category:		
Cash and cash equivalents	**0%**	0%
Equity securities and equity funds	**15**	15
Fixed-income securities and fixed-income funds	**30**	30
Equity investments in managed funds (*Note 5*)	**55**	55
Total	**100%**	100%

11. Employee Benefit Plans (continued)

The value of the plan assets measured at fair value on a recurring basis was determined using the valuation inputs described in Note 6 and categorized at June 30, 2017, as follows (in thousands):

	Level 1	Level 2	Level 3	Total
Assets				
Investments:				
Cash and cash equivalents	**$ 94,427**	**$ –**	**$ –**	**$ 94,427**
Domestic equities	**44,209**	**–**	**–**	**44,209**
International equities	**22,346**	**–**	**–**	**22,346**
Mutual funds and exchange-traded funds:				
Domestic equity funds	**35,341**	**–**	**–**	**35,341**
International equity funds	**45,414**	**–**	**–**	**45,414**
Fixed-income funds	**63,907**	**–**	**–**	**63,907**
Other	**319**	**–**	**–**	**319**
	305,963	**–**	**–**	**305,963**
Investments measured at net asset value or equivalent:				
Fixed-income funds				**312,916**
Hedge funds				**77,892**
Private equity, real estate, and other funds				**142,586**
Total assets at fair value				**$ 839,357**

11. Employee Benefit Plans (continued)

The value of the plan assets measured at fair value on a recurring basis was determined using the valuation inputs described in Note 6, and categorized at June 30, 2016, as follows (in thousands):

	Level 1	Level 2	Level 3	Total
Assets				
Investments:				
Cash and cash equivalents	$ 29,056	$ –	$ –	$ 29,056
Domestic equities	37,183	–	–	37,183
International equities	23,845	–	–	23,845
Mutual funds and exchange-traded funds:				
Domestic equity funds	39,169	–	–	39,169
International equity funds	40,081	–	–	40,081
Fixed-income funds	62,840	–	–	62,840
Other	1,215	–	–	1,215
	233,389	–	–	233,389
Investments measured at net asset value or equivalent:				
Fixed-income funds				301,671
Hedge funds				134,441
Private equity, real estate, and other funds				135,068
Total assets at fair value				$ 804,569

The cash balance plan has $62,722,000 of funding commitments to purchase equity investments in managed funds as of June 30, 2017.

11. Employee Benefit Plans (continued)

TMF Plan

Plan assets of the TMF Plan are held in the Texas Hospital Association Retirement Trust (THART) for member hospitals, which invests plan assets for the plans of its participating hospitals. The investment objectives for the trust are to provide returns, that improve the funded status of the participating hospital's plans over time and reduce pension costs and to receive favorable performance from the pension fund's active managers in exchange for the fees paid to the investment management fund. Investments in the THART are measured at fair value using net asset value per share or its equivalent as a practical expedient and have not been categorized within the fair value hierarchy.

Based on the risk posture of the THART, the trustees developed asset mix targets, that reflect the holdings of the TMF Plan, and which consist primarily of marketable debt and equity securities. The actual and target asset mix is as follows as of June 30, 2017:

	Actual	**Target**
Equity securities	58%	55%
Fixed-income securities	41	44
Cash and cash equivalents	1	1
	100%	100%

Contributions

In fiscal year 2018, CHRISTUS expects to contribute $18,600,000 to the Defined Benefit Plans based on asset values for the plan year beginning January 1, 2017. Contributions to the cash balance plan of $13,500,000, and $13,000,000 were made for plan years beginning January 1, 2017 and 2016, respectively, and contributions to the TMF Plan of $9,000,000 and $1,500,000 were made during fiscal years 2017 and 2016, respectively.

11. Employee Benefit Plans (continued)

Benefit Payments

The following benefit payments, which reflect expected future service and expected benefit payments for services previously rendered, are expected to be paid as follows (in thousands):

	Cash Balance Plan	TMF Plan
2018	$ 56,521	$ 7,126
2019	57,416	7,624
2020	57,782	8,214
2021	58,884	8,825
2022	61,441	9,421
Years 2023–2027	308,280	54,428

Postretirement Health Care Benefits

Comprehensive medical benefits are provided to eligible active employees who, immediately upon retirement and attainment of the age of 55, will receive a pension under the CHRISTUS retirement plan. Postretirement benefits are also provided to former employees who are currently receiving pension benefits. The comprehensive medical program, which is self-insured, provides reimbursement benefits until the participant attains the age of 65. The program also covers dependents of retirees, in addition to former employees. Contributions are required. Retirees may choose one of two self-insured indemnity plan options. Effective February 1, 1999, the CHRISTUS postretirement benefit plan was curtailed prospectively. As of the effective date, new employees or employees who had not vested as of that date are not eligible for the postretirement health care benefits. Effective January 1, 2016, the plan was amended to limit new participants to associates over the age of 52, who otherwise meet the eligibility requirements and elect to retire prior to December 31, 2018. Coverage for new participants is in the form of a subsidy for each retiree and qualifying dependents. The liability associated with the postretirement plan will be reduced as employee participation decreases. Net benefit credit under the postretirement plan was $5,538,000 and $5,119,000 for the years ended June 30, 2017 and 2016. The net benefit obligation was $12,089,000 and $17,764,000 at June 30, 2017 and 2016, respectively, which is included in accrued other long-term obligations on the accompanying balance sheets. The postretirement plan is unfunded.

11. Employee Benefit Plans (continued)

Other defined benefit plans

In addition to the CHRISTUS Cash Balance Plan, CHRISTUS also participates in various defined benefit plans for executives that have been frozen or curtailed. The net benefit (credit) cost under these plans was $(203,000) and $15,000 for the years ended June 30, 2017 and 2016, respectively. The net benefit obligation was $5,977,000 and $6,535,000 for the years ended June 30, 2017 and 2016, respectively. These plans are unfunded.

Defined Contribution Plans

403(b) Matched Savings Plans

The System has a defined-contribution plan (the Matched Savings Plan) covering eligible CHRISTUS employees. Annual employee contributions are limited to 50% of compensation, up to Internal Revenue Service dollar limits. The System will match 50% of employee contributions, not to exceed 6% of annual compensation. Employer contributions vest to the employee over a five-year period. For the years ended June 30, 2017 and 2016, expenses attributable to the Matched Savings Plan amounted to $19,084,000 and $12,333,000, respectively.

CHRISTUS St. Vincent Regional Medical Center (St. Vincent) has two 403(b) defined-contribution plans for bargaining and non-bargaining employees. St. Vincent contributes 4.00% of gross salaries for bargaining employees and 4.25% of gross salaries for non-bargaining employees, as defined by the plans' agreements. The employer contributions are remitted bi-weekly. For fiscal years 2017 and 2016, St. Vincent has incurred $4,463,000 and $3,897,000 in expenses related to the plans, respectively.

Supplemental Executive Retirement Plan (DC SERP)

On January 1, 2014, CHRISTUS established the DC SERP to provide a select group of executives and management of CHRISTUS and its selected subsidiaries and/or affiliates, with supplemental benefits held in a Rabbi trust until paid, primarily at the termination of the individual's service with CHRISTUS. The DC SERP also includes provisions for a deferred compensation plan. As of June 30, 2017 and 2016, the asset and corresponding liability balances recorded related to the DC SERP were $29,465,000 and $22,191,000, respectively. CHRISTUS incurred expense of $15,518,000 and $15,181,000 related to the DC SERP in fiscal years 2017 and 2016, respectively.

11. Employee Benefit Plans (continued)

Other supplemental retirement plans

In addition to DC SERP, CHRISTUS also has various supplement retirement plans to executives that have been frozen. The funds contributed by participants are held in a Rabbi trust until vesting requirements have been satisfied. The System has an asset recorded for the investments in the Rabbi trust with a corresponding liability. As of June 30, 2017 and 2016, the total asset and corresponding liability were $1,704,000 and $2,423,000, respectively.

12. Self-Funded Liabilities

The System self-funds and self-insures for primary professional and general liability, workers' compensation and Texas occupational injury, directors' and officers' liability, employment practices liability and employee medical benefits. A wholly-owned, captive insurance company, Emerald Assurance Cayman Ltd. (Emerald), is used to fund primary professional and general liability, directors' and officers' liability, and employment practices liability. Policies written provide coverage for professional liability with primary limits in the amount of $10,000,000 per claim with no aggregate plus $10,000,000 excess per claim with an aggregate of $10,000,000 for the fiscal years 2017 and 2016. For general liability, policies written provide coverage with primary limits in the amount of $2,000,000 per claim for fiscal years 2017 and 2016. Additionally, the System internally sets aside funds for workers' compensation, Texas occupational injury program, and employee medical benefits based on actuarial analyses.

During fiscal year 2017, CHRISTUS Trinity Mother Frances Health System (TMF), which was acquired by the System on May 1, 2016, maintained a separate insurance program covering all coverages except directors & officers' liability, employment practices liability, property insurance and occupational injury (workers' compensation program). TMF's directors & officers' liability, employment practices liability and property insurance coverages were merged into the System program on May 1, 2016. TMF's occupational injury (workers' compensation program) was merged with the CHRISTUS program on January 1, 2017. TMF was self-insured for the first $3,000,000 of each medical malpractice claim, and funded a healthcare liability trust for payment of malpractice losses and expenses. The estimated self-funded losses include expected claim payments, including settlement costs for reported claims and an actuarial determination of expected losses related to claims that have been incurred but not reported. TMF was also a Texas Certified Self-Insurer for workers' compensation and sets aside funds for workers' compensation and employee medical benefits, for claims occurring up until January 1, 2017. Commercial

12. Self-Funded Liabilities (continued)

insurance policies cover other risk exposures, including ambulance and auto liability; aviation liability; cyber liability; and excess professional, general and workers' compensation liability. Effective July 1, 2017, any claims for all TMF coverages except ambulance and aviation liability will be covered through the System risk finance program.

The assets of the captive insurance company, internally designated funds, and the estimated liability for losses are reported in the consolidated balance sheets. Investment income from the assets and the provision for estimated self-funded losses and administrative costs are reported in the accompanying consolidated statements of operations and changes in net assets. The estimated self-funded losses include expected claim payments, including settlement costs for reported claims and an actuarial determination of expected losses related to claims that have been incurred but not reported.

Emerald was incorporated in the Cayman Islands on June 27, 2003, and operates subject to the provisions of the Companies Law (2003 Revision) of the Cayman Islands. Emerald was granted an Unrestricted Class "B" Insurer's license on June 30, 2003, which it holds subject to the provisions of the Insurance Law (2003 Revision) of the Cayman Islands. Emerald has received an undertaking from the Cayman Islands government exempting it from local income, profits, and capital gains taxes until July 29, 2023. No such taxes are currently levied in the Cayman Islands.

13. Concentrations of Credit Risk

The System grants credit without collateral to its patients, most of who are local residents of the geographies of the various System health care centers and are insured under third-party payor agreements. The mix of accounts receivable from patients and third-party payors at June 30 was as follows:

	2017	**2016**
Medicare	**27%**	30%
Medicaid	**5**	7
Managed care organizations	**30**	29
Commercial insurance	**5**	6
Self-pay	**27**	15
Others	**6**	13
	100%	100%

14. Commitments and Contingencies

Operating Leases

The System leases various equipment and facilities under noncancelable operating leases expiring at various dates through May 20, 2045. Total rental expense in 2017 and 2016 for all operating leases was $71,373,000 and $59,806,000, respectively.

The System's leases have varying terms, which may include renewal or purchase options and escalation clauses that are factored into determining minimum lease payments. The following is a schedule by year of future minimum lease payments under operating leases as of June 30, 2017, that have initial or remaining lease terms in excess of one year (in thousands):

2018	$ 54,570
2019	43,564
2020	34,709
2021	28,123
2022	20,773
Thereafter	59,284
Total	$ 241,023

Financing Transaction

Certain real estate and medical office buildings acquired from Good Shepherd Health System (see Note 19) were part of a sale-leaseback transaction that is being accounted for as a financing transaction due to continuing involvement based on certain contingencies in the agreements, which precluded the de-recognition of the assets when the transaction closed. The terms of the lease agreements range from 10 to 15 years, and lease payments are allocated between interest and a reduction of the financing obligation based on the applicable interest rate. The System's financing obligation is recorded as a component of current and other non-current liabilities totaling $66,422,000 at June 30, 2017. The System is depreciating the assets over their remaining useful lives in accordance with the System's policy, and the net book value of these assets is approximately $65,300,000 at June 30, 2017. The System recognized interest expense of $2,004,000 pertaining to these agreements for the year ended June 30, 2017.

14. Commitments and Contingencies (continued)

Capital Commitments

The System has committed to fund $700,000,000 in capital expenditures related to the acquisition of Trinity Mother Frances Health System. The commitment is to be funded over a period of up to seven years from funds generated by the operations of Trinity Mother Frances Health System and other resources. The System reports the expenditures as of April 30 of each year to Covenant Corporation, an external organization established at the time of the purchase. As of April 30, 2017, the System had expended $215,677,000 toward the commitment.

Other Contingencies

From time to time, the System is subject to litigation in the ordinary course of operations. In management's opinion, any future settlements or judgments on asserted or unasserted claims will not have a material effect on the System's consolidated financial statements.

The System has a compliance program and various internal policies and procedures that management believes will effectively reduce exposure for violations of applicable federal and state health care laws, regulations, and policies. There are matters that may be the subject of reporting to appropriate regulatory authorities or payors, and subject to repayment obligations, recoupments, penalties, and/or fines. There are a number of voluntary and other reviews that may also result in disclosure and/or repayments. There are also matters in which government agencies are pursuing matters directly with CHRISTUS and/or its affiliates.

Because the government's present regulatory and enforcement efforts are widespread across the health care industry and may vary from region to region, the impact of such activities on the System is difficult to predict with certainty. The dynamic regulatory environment, political climate, and the effectiveness of management's compliance efforts could affect the resolution of regulatory, enforcement and payor issues involving the System. The System has implemented, and is continually endeavoring to enhance, various procedures to ensure continued compliance with federal and state requirements. However, there can be no assurance that the compliance program or other measures will always reduce or completely eliminate the System's civil, criminal, regulatory, or payor exposure.

15. Functional Expenses

The System provides general health care services to residents throughout various geographic locations. Expenses related to providing these services at June 30 are as follows (in thousands):

	2017	2016
Health care services	**$ 3,700,056**	$ 2,998,698
Physician services	**423,818**	305,630
General and administrative	**717,315**	608,155
Total	**$ 4,841,189**	$ 3,912,483

16. Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets at June 30 are available for the following purposes (in thousands):

	2017	2014
Purchase of equipment/capital improvement	**$ 39,710**	$ 22,545
Indigent care	**327**	240
Health education	**5,986**	2,667
Health care services	**79,511**	108,265
Community outreach	**12,803**	11,445
Other	**20,684**	17,823
Total	**$ 159,021**	$ 162,985

Permanently restricted net assets at June 30 are restricted as follows (in thousands):

	2017	2016
Investments to be held in perpetuity, the income from which is expendable to support health care services (reported as operating income)	**$ 9,428**	$ 9,311
Endowment requiring income to be added to original gift	**615**	625
Other	**6,837**	6,941
Total	**$ 16,880**	$ 16,877

17. Changes in Consolidated Unrestricted Net Assets

Changes in consolidated unrestricted net assets that are attributable to the System and the non-controlling interests in subsidiaries are as follows (in thousands):

	Controlling Interest	Non-Controlling Interests	Total
Balance, June 30, 2015	$ 2,466,831	$ 144,703	$ 2,611,534
Revenues in excess of expenses	220,630	6,912	227,542
Distributions	–	(1,429)	(1,429)
Acquisition of non-controlling interest	(1,639)	(8,361)	(10,000)
Non-controlling interests from business combinations	–	12,181	12,181
Change in pension liabilities	(85,055)	–	(85,055)
Other activities	(1,724)	(1,204)	(2,928)
Balance, June 30, 2016	2,599,043	152,802	2,751,845
Revenues in excess of expenses	**141,369**	**31,735**	**173,104**
Distributions	**–**	**(6,913)**	**(6,913)**
Acquisition of non-controlling interest	**(202)**	**(318)**	**(520)**
Non-controlling interests from business combinations	**–**	**20,784**	**20,784**
Change in pension liabilities	**20,688**	**–**	**20,688**
Other activities	**37,805**	**3,765**	**41,570**
Balance, June 30, 2017	**$ 2,798,703**	**$ 201,855**	**$ 3,000,558**

18. International Operations

CHRISTUS Muguerza

At June 30, 2017, the System owned an 85.6% interest in CHRISTUS Muguerza, S.A. de C.V. (CHRISTUS Muguerza), headquartered in Monterrey, Mexico. CHRISTUS Muguerza is a private health care system and is subject to taxes in accordance with the regulations of the Republic of Mexico. The financial statements of CHRISTUS Muguerza are presented in accordance with U.S. GAAP and are included in the CHRISTUS consolidated financial statements. CHRISTUS Muguerza has net assets of $112,127,000 and $97,217,000 at June 30, 2017 and 2016, respectively.

In November 2012, the System and certain non-controlling interest holders entered into a revised shareholders' agreement, whereby the non-controlling interest holders of CHRISTUS Muguerza have a series of put options through December 31, 2028. These options may require the System to acquire shares, subject to an annual cap of either $3,500,000 or $2,000,000 depending on the year, at a formula price as defined. At June 30, 2017 and 2016, respectively, the System had $5,507,000 and $5,539,000 recorded as unrestricted net assets attributable to non-controlling interest to reflect such obligation to the non-controlling interest holders in connection with the agreement.

By purchasing 560,511 shares put forth by the non-controlling shareholders in accordance with the agreement during 2017, the System increased its ownership interest in CHRISTUS Muguerza from 85.3% to 85.6%, for cash consideration of $524,000. During the year ended June 30, 2016, the System acquired 10,205,401 shares from non-controlling shareholders for cash consideration of $10,000,000.

CHRISTUS Chile SpA

CHRISTUS signed a memorandum of understanding (MOU) with PUC in Santiago, Chile, to enter into a joint venture agreement for the ownership, operation, and expansion of PUC's health network. PUC is owned by the Catholic Church and operates one of the largest health systems in Chile for medical care and teaching. The System anticipates achieving the structure outlined in the MOU through a series of transactions. CHRISTUS and PUC have entered into certain transactions as described below and are currently undergoing due diligence and negotiations of such transactions.

18. International Operations (continued)

In January 2014, under the terms of the MOU, CHRISTUS Chile SpA purchased a 40% interest in Salud U.C. from PUC for $20,878,000. Salud U.C. had an existing 0.74% interest in Centro Medico Monsenor Carlos Casanueva S.A., a 60% interest in Clinica UC S.A., and a 50% interest in both Servicos Clinicos San Carlos Apoquindo S.A. and Inmobilaria Clinicos San Carlos Apoquindo S.A. (collectively referred to as San Carlos).

In May 2014, CHRISTUS Chile Limitada, a wholly-owned Chilean subsidiary of CHRISTUS Chile SpA, purchased 100% of the shares of Inversiones San Carlos, SpA, a Chilean corporation, from Colmena Salud S.A. for cash consideration of $68,000,000. Inversiones San Carlos SpA owned a 50% interest in San Carlos, of which Salud U.C. was also a 50% owner.

Effective July 31, 2015, CHRISTUS and PUC completed a transaction to reorganize Salud U.C. into two separate entities. The first entity holds the 50% interest in San Carlos and is 100% owned by PUC. The second entity, Inversiones UC CH SpA (Inversiones UC), holds the remaining assets of Salud U.C. and is owned 60% by PUC and 40% by CHRISTUS. In consideration for this reorganization, PUC agreed to refund $10,000,000 of the original purchase price of $20,878,000 to CHRISTUS.

Effective October 1, 2015, CHRISTUS and PUC also completed a transaction to reorganize the San Carlos operations into one joint venture entity, Clinica San Carlos de Apoquindo SpA (Clinica San Carlos), which is owned 50% by CHRISTUS and 50% by PUC. Since CHRISTUS and PUC each had a 50% interest in the San Carlos operations both before and after this restructuring, no payments were made in connection with this transaction.

In May 2016, CHRISTUS and PUC executed several agreements, including a shareholders' agreement and an integration agreement (the PUC Agreements), that modify and finalize the specific terms and legal structure of the joint venture arrangement originally contemplated in the MOU. The PUC Agreements outline the timing of when specific assets and additional capital contributions will be made to Inversiones UC and Clinica San Carlos, which will occur in three closings. The first closing took place on July 15, 2016, at which time CHRISTUS made additional investments of $14,560,000 to Clinica San Carlos and $2,838,000 to Inversiones UC. The second closing is expected to occur prior to August 31, 2017, and the final closing is expected to occur prior to March 31, 2018. Under the terms of the PUC Agreements, CHRISTUS is expected to make additional capital contributions to Inversiones UC or Clinica San Carlos at each of the three closings. The specific amounts of capital contributions may vary but are expected to be no less than $134,500,000.

18. International Operations (continued)

The investments in Inversiones UC and Clinica San Carlos are treated as equity method investments. Discussion of the investments and earnings are in Note 8.

In fiscal year 2015, Amatista Financing Company, Ltd (Amatista), a wholly-owned subsidiary of CHRISTUS, executed a loan agreement with PUC, a related party, and during 2015 loaned PUC $30,000,000 under the terms of that agreement. The note carried a one-year maturity date, which was subsequently extended to April 2018. Under the terms of the PUC Agreements, repayment of this note is one of the various transactions expected to occur at the third closing. The interest rate on the note is 3.35% per annum. In July 2016, in connection with the initial closing under the PUC Agreements discussed above, Amatista executed two new loans with PUC for $20,000,000 and $8,370,000 (collectively, including the original loan, the PUC Loans).

At June 30, 2017 and 2016, accrued interest related to the PUC Loans was $3,411,000 and $1,627,000, respectively. The note is convertible into additional capital contributions as outlined in the PUC Agreements. The note is reported within other assets in the accompanying consolidated balance sheets.

CHRISTUS and PUC entered into an interim management agreement on March 1, 2013, under which CHRISTUS provides management services to the PUC health network through the due diligence and negotiation period. Concurrently with the execution of the PUC Agreements, CHRISTUS and PUC executed a new management agreement, under which CHRISTUS provides management services to PUC's primary hospital. CHRISTUS and Clinica San Carlos also entered into a management agreement under which CHRISTUS provides management services to all of the San Carlos operations. The initial term of both new management agreements is 25 years. CHRISTUS recorded other revenue related to the interim management agreement and the new management agreements of $9,301,000 and $7,173,000 during the years ended June 30, 2017 and 2016, respectively.

CHRISTUS Health Colombia S.A.S.

Effective June 14, 2016, CHRISTUS Health Colombia S.A.S, a wholly-owned subsidiary of CHRISTUS, signed definitive agreements with Coomeva in Colombia. In September 2016, CHRISTUS closed on various transactions outlined in the definitive agreements, resulting in CHRISTUS obtaining a non-controlling ownership interest in various Coomeva companies. Discussion of the investments and related earnings on those investments is in Note 8.

18. International Operations (continued)

In addition to these investments, in September 2016 CHRISTUS executed a loan with Coomeva EPS, an affiliate of Coomeva, for $2,578,000. Coomeva EPS is a health insurance company that contracts with the Colombian government. The loan is convertible into equity

securities of Coomeva EPS after 30 months and carries a put option that CHRISTUS can exercise upon the occurrence of certain triggering events prior to conversion.

As part of the definitive agreements, CHRISTUS also entered into management agreements with Coomeva affiliates and earns a management fee for services provided under those agreements. During the year ended June 30, 2017, CHRISTUS recorded $3,642,000 in management fee revenue under these agreements, which is classified as other revenue in the accompanying financial statements.

19. Significant Events

Business Combinations

Good Shepherd Health System

On February 1, 2017, CHRISTUS acquired Good Shepherd Health System (GSHS). The transaction was structured as a member substitution arrangement whereby CHRISTUS became the sole corporate member of GSHS without the transfer of consideration. The transaction was accounted for using the acquisition method of accounting.

19. Significant Events (continued)

In accordance with ASC 958-805, *Not-for-profit Entities*, CHRISTUS recognized an inherent contribution as the excess of the acquisition-date fair values of the assets acquired and liabilities assumed over the consideration transferred. The fair values assigned are preliminary and subject to change as valuation activities are finalized and are summarized as follows:

Consideration transferred	$ –
Fair values of assets acquired and liabilities assumed:	
Cash and investments	13,548
Patient accounts receivable, net	35,537
Other current assets	23,229
Property and equipment, net	215,844
Other noncurrent assets	85,941
Accounts payable, accrued and other current liabilities	(77,514)
Long-term debt	(215,491)
Other liabilities	(3,955)
Total fair values of assets acquired and liabilities assumed	77,139
Less non-controlling interest assumed	(3,799)
Inherent contribution	$ 73,340
Classification of inherent contribution:	
Unrestricted	$ 72,694
Temporarily restricted	646
	$ 73,340

Existing donor-imposed restrictions on the use of the net assets acquired were retained in purchase accounting. CHRISTUS also incurred $2,584,000 in transaction costs associated with the GSHS acquisition, which were expensed as a reduction of the inherent contribution, for a net unrestricted gain recognized within inherent contribution from business combinations of $70,756,000.

For the period from February 1, 2017 through June 30, 2017, total operating revenue and revenues in excess (deficit) of expenses attributable to GSHS were $142,214,000 and $(13,672,000), respectively.

19. Significant Events (continued)

CHRISTUS Hopkins Health Alliance

Effective July 12, 2016, CHRISTUS and Hopkins County Hospital District (Hopkins) executed a contribution agreement, under which CHRISTUS and Hopkins contributed various assets to a newly formed entity, CHRISTUS Hopkins Health Alliance (CHHA). CHRISTUS contributed cash of $18,448,000 to CHHA in exchange for a 51% controlling ownership interest in CHHA, and Hopkins contributed substantially all of the assets and operations of Hopkins County Memorial Hospital and Hopkins County Physician Services d/b/a Memorial Clinic Services in exchange for a 49% ownership interest in CHHA. Based on finalized valuation adjustments for assets acquired and liabilities assumed, $3,115,000 of the CHRISTUS cash contribution was refunded during the third quarter of 2017. The transaction has been accounted for as an acquisition. In accordance with ASC 958-805, CHRISTUS recognized an inherent contribution as the excess of the acquisition-date fair values of the assets acquired and liabilities assumed over the consideration transferred. The fair values assigned are summarized as follows:

Consideration transferred	
Cash consideration	$ 15,334
Fair value of non-controlling interest	16,985
Total consideration transferred	32,319
Fair values of assets acquired and liabilities assumed:	
Current assets and liabilities, net	28,451
Property and equipment, net	4,250
Other noncurrent assets	3,023
Long-term debt	(1,060)
Fair values of assets acquired and liabilities assumed	34,664
Inherent contribution	$ 2,345

For the period from July 12, 2016 through June 30, 2017, total operating revenue and revenues in excess (deficit) of expenses attributable to CHHA were $51,913,000 and $(12,583,000), respectively.

19. Significant Events (continued)

Acquisition of Trinity Mother Frances Health System and Subsidiaries

On May 1, 2016, CHRISTUS acquired TMF. TMF and its subsidiaries are located in Tyler, Texas and surrounding areas. TMF is a Catholic health system sponsored by the Congregation of the Sisters of the Holy Family of Nazareth (SHFN). As part of the agreement, SHFN became a third sponsoring congregation of CHRISTUS, holding a 27% membership interest. The transaction was structured as a member substitution arrangement whereby CHRISTUS became the sole corporate member of TMF without the transfer of consideration. However, CHRISTUS agreed to donate $50,000,000 to the Trinity Mother Frances Health System Foundation, which was also renamed the CHRISTUS-Trinity Mother Frances Foundation (the Foundation), with $10,000,000 due at closing and the remaining $40,000,000 to be donated in equal annual installments of $10,000,000 each over the next four years. The Foundation is controlled by CHRISTUS through its control of TMF, and this intercompany receivable and payable is eliminated in consolidation. The transaction was accounted for using the acquisition method of accounting.

In accordance with ASC 958-805, CHRISTUS recognized an inherent contribution as the excess of the acquisition-date fair values of the assets acquired and liabilities assumed over the consideration transferred. There were no material adjustments to the fair values assigned in fiscal year 2016 purchase accounting, which are summarized as follows:

19. Significant Events (continued)

Consideration transferred	$ –
Fair values of assets acquired and liabilities assumed:	
Cash and investments	359,304
Patient accounts receivable, net	75,834
Other current assets	9,963
Property and equipment, net	381,279
Intangible asset–trade name	46,000
Other noncurrent assets	31,161
Accounts payable, accrued and other current liabilities	(104,622)
Long-term debt	(202,602)
Pension liability	(80,230)
Other liabilities	(24,078)
Total fair values of assets acquired and liabilities assumed	492,009
Inherent contribution	$ 492,009

Classification of inherent contribution:	
Unrestricted	$ 478,347
Temporarily restricted	11,258
Permanently restricted	2,404
	$ 492,009

Existing donor-imposed restrictions on the use of the net assets acquired were retained in purchase accounting. CHRISTUS also incurred $3,807,000 in transaction costs associated with the TMF acquisition, which were expensed as a reduction of the inherent contribution, for a net unrestricted gain recognized within inherent contribution from business combinations of $474,540,000.

19. Significant Events (continued)

For the period from May 1, 2016 through June 30, 2016, total operating revenue and revenues in excess (deficit) of expenses attributable to TMF were $122,606,000 and $(1,398,000), respectively. For the year ended June 30, 2017, total operating revenue and revenues in excess (deficit) of expenses attributable to TMF were $833,834,000 and $56,427,000, respectively.

Acquisition of Velocity Care

Effective November 1, 2015, CHRISTUS closed on a transaction under which the owners of Velocity MD, LLC and Velocity Care Arkansas, PLLC (jointly, Velocity Care) contributed substantially all of the assets used in the operation of Velocity Care to Ambulatory Strategies Physician Group of Louisiana, LLC ("ASPG-LA"), a newly formed joint venture, in exchange for a 49% ownership interest in ASPG-LA and cash consideration paid by Ambulatory Strategies Physician Group (ASPG), which owns the remaining 51% of ASPG-LA. ASPG is a wholly-owned subsidiary of CHRISTUS. The purchase price for Velocity Care was $10,590,000, with $5,401,000 paid in cash at closing and the remaining $5,189,000 as equity consideration in the form of the membership units of ASPG-LA. Acquisition costs related to this transaction, which were recorded as other expenses, were immaterial. The purchase was allocated to the fair values of the assets acquired and liabilities assumed as of the acquisition date, with the remaining amount recorded as goodwill, as summarized in the table below (in thousands):

Consideration transferred:	
Cash consideration	$ 5,401
Fair value of non-controlling interest	5,189
Total consideration transferred	10,590
Fair values of assets acquired and liabilities assumed:	
Current assets and liabilities, net	596
Property and equipment	1,509
Intangible assets	38
Total fair values of assets acquired and liabilities assumed	2,143
Goodwill	$ 8,447

19. Significant Events (continued)

Goodwill arising from the acquisition consists largely of the economies of scale and synergies expected to be gained from combining the operations of Velocity Care with the System.

Acquisition of Central Texas Ambulatory Endoscopy Center

On April 1, 2016, CHRISTUS closed on a transaction under which the owners of Central Texas Ambulatory Endoscopy Center, LLC (CTAEC) sold substantially all of the assets used in the operation of CTAEC to CHRISTUS Santa Rosa Outpatient Surgery - New Braunfels, LP (NB PASC), a majority-owned subsidiary of CHRISTUS, in exchange for cash and an equity ownership interest in NB PASC. The real estate assets of CTAEC were not sold, and concurrently with the closing of the purchase and sale agreement, NB PASC entered into a 15-year lease of the real estate assets from CTAEC. The purchase price for CTAEC was $17,625,000, with $10,633,000 paid in cash at closing and the remaining $6,992,000 as equity consideration in the form of membership units of NB PASC. Acquisition costs related to this transaction, which were recorded as other expenses, were immaterial. The purchase price was allocated to the fair values of the assets acquired and liabilities assumed as of the acquisition date, with the remaining amount recorded as goodwill, as summarized in the table below (in thousands):

Consideration transferred:	
Cash consideration	$ 10,633
Fair value of non-controlling interest	6,992
Total consideration transferred	17,625
Fair values of assets acquired and liabilities assumed:	
Current assets and liabilities, net	230
Property and equipment	204
Intangible assets	240
Total fair values of assets acquired and liabilities assumed	674
Goodwill	$ 16,951

Goodwill arising from the acquisition consists largely of the economies of scale and synergies expected to be gained from combining the operations of CTAEC with the System.

19. Significant Events (continued)

Pro Forma Financial information

Pro forma results as if the acquisitions of Velocity Care and CTAEC had occurred as of July 1, 2015 would be immaterial to CHRISTUS. Had the acquisitions of GSHS, CHHA, and TMF occurred as of July 1, 2015, the unaudited pro forma total operating revenue and revenues in excess (deficit) of expenses before the effect of non-controlling interest of CHRISTUS would have been $5,047,225,648 and $44,990,262, respectively for the year ended June 30, 2017, and $4,776,538,000 and $(308,912,000), respectively for the year ended June 30, 2016. In calculating these unaudited pro forma numbers, the effects of the inherent contribution and related transaction costs have been excluded, and the effects of incremental depreciation resulting from recording acquired long-lived assets have been included.

Houston Methodist St. John and St. Catherine

As discussed in Note 8, on February 1, 2014, CHRISTUS Gulf Coast sold a controlling interest of 70% of CHRISTUS St. John Hospital (St. John) to Methodist Health Centers. On January 31, 2014, CHRISTUS Gulf Coast also contributed the land, building, and improvements of CHRISTUS Health St. Catherine Hospital (St. Catherine) to Houston Methodist St. Catherine Real Property Company, in which it retained a 30% non-controlling membership interest. In July 2016, CHRISTUS Gulf Coast closed on transaction to sell its remaining 30% interest in both St. John and St. Catherine to Methodist Health Centers for $43,140,000, which approximates book value. CHRISTUS received $21,570,000 in cash. A one-year note with a .40% interest rate was signed for the remaining $21,570,000. Principal and interest on the note are due in one installment on July 5, 2017. CHRISTUS Gulf Coast continues to provide certain services to Methodist Health Centers under the terms of transitional service agreements.

Gain from sale of Unconsolidated Organizations

The System had a 50% membership interest in Baptist St. Anthony's Health System (BSAHS), a Texas nonprofit corporation. In 2013, BSAHS completed a transaction that resulted in the transfer of substantially all the assets of BSAHS to a subsidiary of Ardent Health Services. In 2017 and 2016, the System recorded gains from the sale of BSAHS of $1,700,000 and $16,000,000, respectively, resulting from the subsequent distributions of sale proceeds initially deposited into an escrow account. The gains are included in equity income from unconsolidated organizations for the years ended June 30, 2017 and 2016.

19. Significant Events (continued)

The System had a 13.1% ownership interest in Preferred Professional Insurance Company (PPIC), a taxable Nebraska corporation. Effective August 1, 2014, PPIC was acquired by Pro Med. The System recorded an additional gain from the sale of PPIC during the year ended June 30, 2016 of $3,806,000, resulting from subsequent distributions of sale proceeds initially deposited into an escrow account. The gain is included in equity in income from unconsolidated organizations for the year ended June 30, 2016.

20. Subsequent Events

The System evaluated events and transactions occurring subsequent to June 30, 2017, through September 15, 2017, the date of issuance of the consolidated financial statements. During this period, there were no subsequent events requiring recognition in the consolidated financial statements. However, the following events and transactions occurred that warrant disclosure.

Lake Area Medical Center

Effective July 1, 2017, CHRISTUS closed on a transaction with Community Health Systems, Inc. (CHS), in which CHRISTUS paid approximately $30,000,000 to acquire Lake Area Medical Center (LAMC). LAMC is a full-service acute care hospital located in Lake Charles, Louisiana. The purchase price is subject to certain working capital and other adjustments. The transaction has been accounted for as an acquisition, for which the purchase price allocation has not yet been finalized.

Imperial Calcasieu Surgical Center

Effective August 1, 2017, CHRISTUS closed on a transaction with Imperial Calcasieu Surgery Center, LLC (ICSC), in which CHRISTUS paid approximately $20,090,000 to acquire a 51% majority ownership in ICSC, an outpatient surgical center, and land previously owned by ICSC. The purchase price for the acquisition is subject to certain working capital and other adjustments, and a portion of the purchase price was placed in escrow pending resolution of those adjustments. The transaction has been accounted for as an acquisition, for which the purchase price allocation has not yet been finalized.

20. Subsequent Events (continued)

Hurricane Harvey

In August 2017, various hospitals and other physical structures in the CHRISTUS Spohn, CHRISTUS Southeast Texas, CHRISTUS Gulf Coast, and CHRISTUS Louisiana Regions sustained damage from Hurricane Harvey resulting in property damage and business interruption. CHRISTUS is in the process of estimating total damages sustained as a result of this event. CHRISTUS maintains property and business interruption insurance coverage through independent property and casualty companies. Additionally, CHRISTUS has self-insured property and casualty losses at the individual facility level through a wholly-owned captive insurance company, Emerald Assurance.

Sale of Controlling Interest in Long Term Acute Care

On August 1, 2017, CHRISTUS Continuing Care executed an asset contribution agreement, under which CHRISTUS contributed substantially all of the assets of its long-term acute care hospitals (LTAC) to a newly formed entity, Southwest Post-Acute Care Partnership, LLC (Southwest Partnership), in exchange for $4,506,000 cash proceeds and a 7.28% non-controlling interest in Southwest Partnership. The transaction closed on September 1, 2017.

Sale of Controlling Interest in Home Care

On August 1, 2017, CHRISTUS Continuing Care executed an asset contribution agreement, under which CHRISTUS contributed substantially all of the assets of its home care business to Southwest Partnership in exchange for $20,250,000 cash proceeds and a 32.72% non-controlling interest in Southwest Partnership. The transaction closed on September 1, 2017.

Supplementary Information

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Report of Independent Auditors on Supplementary Information

The Board of Directors
CHRISTUS Health

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying community benefit information is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management. The information has not been subjected to the auditing procedures applied in the audit of the consolidated financial statements and, accordingly, we express no opinion on it.

Ernst & Young LLP

September 15, 2017

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CHRISTUS Health

Community Benefit (Unaudited)

CHRISTUS Health (CHRISTUS or the System) complies with the Catholic Health Association's (CHA) *A Guide for Planning and Reporting Community Benefits* (©2008) and the State of Texas reporting requirements. CHA guidelines have adopted the instructions for IRS Form 990, Schedule H, *Hospitals*.

Following is a summary of the System's quantifiable costs of community benefits provided for the years ended June 30 (in thousands):

	2017	2016
	(Unaudited)	
Programs and services for the poor and underserved:		
Charity care at unpaid cost	**$ 246,550**	$ 215,404
Unpaid cost of Medicaid and other public programs	**74,420**	39,229
Community services for the poor and underserved	**40,369**	52,960
Total programs and services for the poor and underserved	**361,339**	307,593
Community services for the broader community:		
Education and research	**2,399**	8,450
Other community services	**4,102**	4,175
Total community services for the broader community	**6,501**	12,625
Total community benefits	**$ 367,840**	$ 320,218

The totals are calculated following CHA guidelines and adhere to the IRS Form 990, Schedule H methodology. CHRISTUS has multiple reporting requirements of charity care and community benefit, which vary based on the definitional and timing requirements of each requesting organization. For comparability, the unpaid cost of Medicaid and other public programs total for fiscal year 2016 has been updated to reflect the change in methodology effective for fiscal year 2017 reporting.

In addition to the community benefits reported above, the State of Texas requires that the unpaid costs of Medicare and other government-sponsored programs be reported. For the years ended June 30, 2017 and 2016, the unpaid costs of these programs were $334,463,000 and $222,846,000, respectively. The unpaid costs of the Medicare program represent the cost of providing services to primarily elderly beneficiaries of the Medicare program, in excess of governmental and managed care contract payments. The unpaid costs of other government-sponsored programs represent the cost for providing health care services to the beneficiaries of the Department of Defense civilian care, included as per the State of Texas guidelines.

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