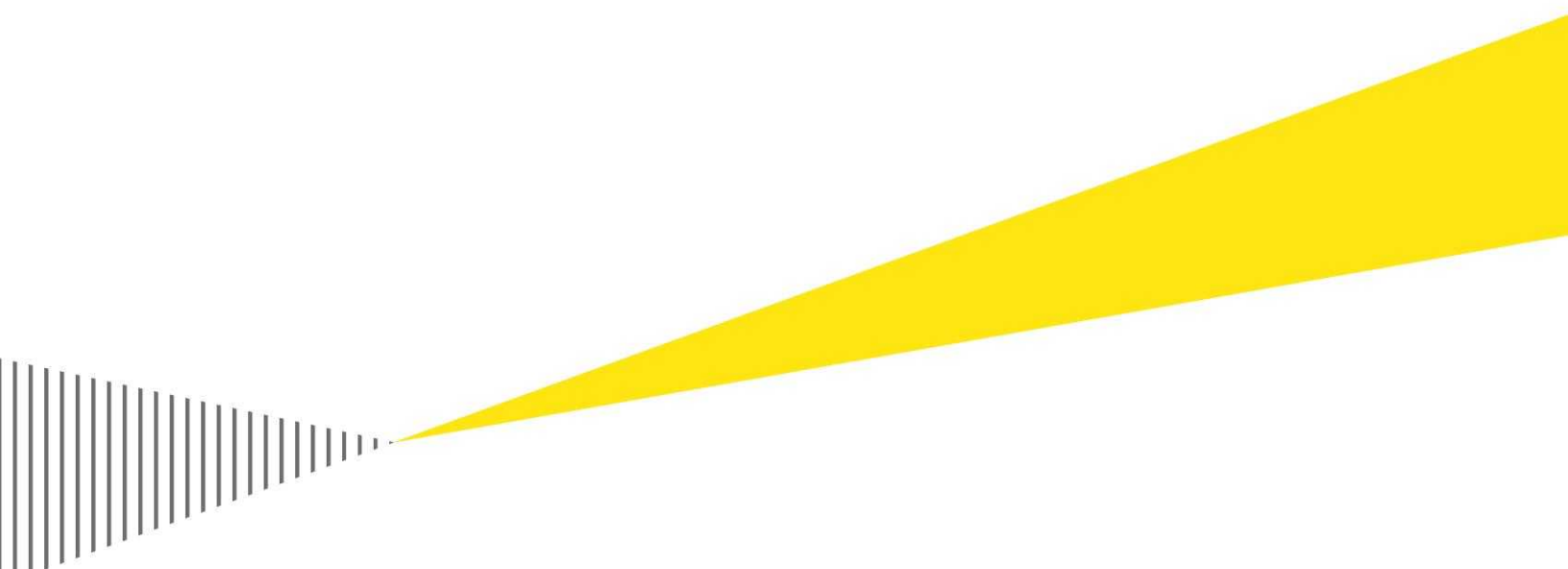


CONSOLIDATED FINANCIAL STATEMENTS,
SUPPLEMENTARY INFORMATION AND REPORTS ON
FEDERAL AND STATE AWARD PROGRAMS

CHRISTUS Health
Years Ended June 30, 2016 and 2015
With Reports of Independent Auditors

Ernst & Young LLP



CHRISTUS Health

Consolidated Financial Statements, Supplementary Information and Reports on Federal and State Award Programs

Years Ended June 30, 2016 and 2015

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Report of Independent Auditors

The Board of Directors
Ernie Sadau, Chief Executive Officer
Randolph Safady, Chief Financial Officer
CHRISTUS Health

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of CHRISTUS Health, which comprise the consolidated balance sheets as of June 30, 2016 and 2015, 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 consolidated 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 consolidated 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 consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement.

An audit involves performing procedures to obtain evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the 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 consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of CHRISTUS Health as of June 30, 2016 and 2015, and the results of its consolidated operations and changes in its net assets and its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

Supplementary Information

Our audits were performed for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying schedule of compensation information as required by the Louisiana Revised Statute 24: 513A(1)(a)(3) and schedule of expenditures of federal and state awards as required by Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* and the State of Texas *Uniform Grant Management Standards* are presented for purposes of additional analysis and are not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain other procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the schedule of compensation information and the schedule of expenditures of federal and state awards are fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we also have issued our report dated September 16, 2016, on our consideration of CHRISTUS Health's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering CHRISTUS Health's internal control over financial reporting and compliance.

Ernst + Young LLP

September 16, 2016

CHRISTUS Health

Consolidated Balance Sheets

	June 30	
	2016	2015
	<i>(In Thousands)</i>	
Assets		
Current assets:		
Cash and cash equivalents	\$ 483,664	\$ 349,688
Short-term investments and equity in managed funds	620,490	755,286
Assets whose use is limited or restricted, required for current liabilities	58,387	49,802
Patient accounts receivable, net of allowance for doubtful accounts of \$171,926 and \$129,072 at June 30, 2016 and 2015, respectively	456,609	365,943
Notes and other receivables	127,039	208,076
Inventories	93,415	84,921
Other current assets	86,239	62,080
Total current assets	1,925,843	1,875,796
Assets whose use is limited or restricted, less current portion	869,085	634,556
Property and equipment, net of accumulated depreciation	1,940,183	1,543,749
Other assets:		
Investments in unconsolidated organizations	148,095	148,805
Goodwill and intangible assets, net	136,661	154,958
Beneficial interest in supporting organizations and other restricted assets	86,154	87,654
Other assets, including notes receivable from related party	114,500	90,433
Total other assets	485,410	481,850
 Total assets	 \$ 5,220,521	 \$ 4,535,951

	June 30	
	2016	2015
	<i>(In Thousands)</i>	
Liabilities and net assets		
Current liabilities:		
Accounts payable and accrued expenses	\$ 461,529	\$ 376,179
Accrued employee compensation and benefits	204,615	152,385
Estimated third-party settlements, net	37,698	25,568
Current portion of long-term debt	55,815	35,627
Long-term obligations subject to remarketing agreements	—	41,435
Total current liabilities	759,657	631,194
Long-term debt, less current portion	979,682	802,783
Accrued pension benefits	209,334	50,646
Derivative financial instruments	168,520	109,172
Other long-term obligations – including self-funded liabilities, less current portion	171,621	160,180
Total liabilities	2,288,814	1,753,975
Net assets		
Unrestricted:		
Attributable to CHRISTUS Health	2,599,043	2,466,831
Attributable to non-controlling interest	152,802	144,703
Total unrestricted	2,751,845	2,611,534
Temporarily restricted	162,985	155,679
Permanently restricted	16,877	14,763
Total net assets	2,931,707	2,781,976
Total liabilities and net assets	\$ 5,220,521	\$ 4,535,951

See accompanying notes.

CHRISTUS Health

Consolidated Statements of Operations and Changes in Net Assets

	Year Ended June 30	
	2016	2015
	<i>(In Thousands)</i>	
Revenues:		
Patient service revenue (net of contractual allowances and discounts)	\$ 3,585,511	\$ 3,414,691
Provision for bad debts	(267,631)	(180,953)
Net patient service revenue less provision for bad debts	3,317,880	3,233,738
Premium revenue	189,878	161,017
Inherent contribution from business combination	474,540	—
Other revenue	205,385	179,291
Equity in income of unconsolidated organizations	24,730	25,666
Total revenues	4,212,413	3,599,712
Expenses:		
Employee compensation and benefits	1,680,930	1,549,142
Services and other	1,267,389	1,174,050
Supplies	654,272	632,812
Goodwill impairment charges	91,916	—
Depreciation and amortization, including impairment	196,986	164,695
Interest	20,990	23,169
Total expenses	3,912,483	3,543,868
Operating income	299,930	55,844
Non-operating investment loss	(71,573)	(19,884)
Other non-operating loss	(815)	(110)
Revenues in excess of expenses	227,542	35,850
Less revenues in excess of expenses attributable to non-controlling interest	6,912	22,581
Revenues in excess of expenses attributable to CHRISTUS Health	220,630	13,269

CHRISTUS Health

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

	Year Ended June 30	
	2016	2015
	<i>(In Thousands)</i>	
Changes in unrestricted net assets:		
Revenues in excess of expenses attributable to CHRISTUS Health	\$ 220,630	\$ 13,269
Unrealized loss on investments	(3,085)	(3,077)
Change in pension liabilities	(85,055)	(31,790)
Change in non-controlling interest	8,099	17,914
Other	(278)	(14,255)
Changes in unrestricted net assets	<u>140,311</u>	<u>(17,939)</u>
Temporarily restricted net assets:		
Temporarily restricted net assets acquired	11,258	—
Net change in beneficial interest	(999)	1,912
Contributions	13,692	21,672
Unrealized loss on investments	(905)	(1,496)
Net assets released from restrictions and other	<u>(15,740)</u>	<u>(2,650)</u>
Changes in temporarily restricted net assets	<u>7,306</u>	<u>19,438</u>
Permanently restricted net assets:		
Permanently restricted net assets acquired	2,404	—
Net change in beneficial interest	(132)	2,761
Other	<u>(158)</u>	<u>532</u>
Changes in permanently restricted net assets	<u>2,114</u>	<u>3,293</u>
Change in net assets	149,731	4,792
Net assets – beginning of year	<u>2,781,976</u>	<u>2,777,184</u>
Net assets – end of year	<u>\$ 2,931,707</u>	<u>\$ 2,781,976</u>

See accompanying notes.

CHRISTUS Health

Consolidated Statements of Cash Flows

	Year Ended June 30	
	2016	2015
	<i>(In Thousands)</i>	
Operating activities		
Changes in net assets	\$ 149,731	\$ 4,792
Adjustments to reconcile changes in net assets to net cash provided by operating activities:		
Inherent contribution from business combination	(474,540)	—
Change in beneficial interest	1,131	(4,673)
Change in pension liabilities recognized in net assets	85,055	31,790
Contributions of temporarily restricted net assets	(13,962)	(21,672)
Distributions to and acquisitions of non-controlling interest	11,429	8,505
Net assets received in formation of partnership, primarily goodwill	—	(6,735)
Restricted assets acquired in business combination	(13,662)	—
Non-controlling interest acquired in business combination	(12,181)	—
Equity in income of unconsolidated organizations	(24,730)	(25,666)
Unrealized investment loss	25,724	8,818
Depreciation and amortization	196,986	164,695
Provision for uncollectible accounts	267,631	180,953
Goodwill impairment charge	91,916	—
Change in derivative fair value	59,348	17,362
Gain on disposal of property and equipment	(695)	(695)
Gain on contribution to joint ventures, net	—	(3,316)
Foreign currency translation loss	14,437	19,518
Changes in operating assets and liabilities, net of acquisitions:		
Increase in net patient accounts receivable	(282,462)	(187,792)
Decrease in investments	181,834	26,043
Decrease (increase) in notes and other receivables	78,090	(5,904)
(Increase) decrease in other current assets and inventories	(19,473)	2,336
Increase (decrease) in accounts payable, accrued expenses, and accrued employee compensation and benefits	40,235	(28,852)
Increase (decrease) in net third-party payor settlements	5,189	(27,592)
Decrease in other long term liabilities	(19,570)	(28,955)
Net cash provided by operating activities	347,461	122,960
Investing activities		
Purchases of property and equipment	(215,503)	(219,953)
Proceeds from sale or disposal of property and equipment	285	2,701
Proceeds from sale of majority interest in operating entities	—	3,316
Proceeds and dividends from sale of equity investment in unconsolidated subsidiary	19,806	39,290
Distributions from investments in unconsolidated organizations	11,693	5,601
Decrease in securities pledged to creditors	—	1,846
Increase in other assets	(3,514)	(19,885)
Increase in security lending collateral	—	1,987
Acquisitions of health care entities, net of cash acquired	23,588	(13,581)
Net cash used in investing activities	(163,645)	(198,678)

CHRISTUS Health

Consolidated Statements of Cash Flows (continued)

	Year Ended June 30	
	2016	2015
	<i>(In Thousands)</i>	
Financing activities		
Contributions of temporarily restricted net assets	\$ 13,692	\$ 21,672
Costs associated with debt refinancing/conversion	(1,732)	(776)
Payments on long-term debt	(50,371)	(37,852)
Distributions to and acquisitions of non-controlling interest	(11,429)	(8,505)
Decrease in payable under security lending agreements	—	(1,987)
Net cash used in financing activities	(49,840)	(27,448)
Net increase (decrease) in cash and cash equivalents	133,976	(103,166)
Cash and cash equivalents – beginning of year	349,688	452,854
Cash and cash equivalents – end of year	\$ 483,664	\$ 349,688
Non-cash investing and financing transactions		
Capital lease and debt obligations incurred for property and equipment	\$ 5,092	\$ 25,408
Net asset received in formation of partnership, primarily goodwill	\$ —	\$ 6,735
Capital lease obligation satisfied through asset acquisition	\$ —	\$ 13,320
Supplemental disclosure of cash flow information		
Cash paid during the year for interest (net of amount capitalized)	\$ 33,813	\$ 26,287

See accompanying notes.

CHRISTUS Health

Notes to Consolidated Financial Statements

June 30, 2016

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 Health 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 and commonly referred to as regions or entities. For purposes of these consolidated financial statements, the System is defined as CHRISTUS's 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 and Chile.

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).

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

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 Health 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, excluding the provision for bad debt expense, was approximately \$218,393,000 and \$209,573,000 for the years ended June 30, 2016 and 2015, 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.

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

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

2. Community Health (continued)

services, from community health centers to 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 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

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

3. Summary of Significant Accounting Policies (continued)

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

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

Investments

The System's investment portfolio is classified as trading, with unrealized gains and losses included in revenues in excess of expenses. 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.

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

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 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 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

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

3. Summary of Significant Accounting Policies (continued)

identified. Impairment losses of \$31,117,000 were recorded as depreciation expense in fiscal year 2016. In determining the amount of the impairment, the fair values of the affected assets were estimated primarily using a discounted cash flow methodology. There was no impairment loss recognized in 2015.

Investments in Unconsolidated Organizations

The System has investments in certain organizations for which it does not have a majority ownership interest or significant 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 \$6,912,000 and \$22,581,000 for the years ended June 30, 2016 and 2015, 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) Topic, 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, 2016 and 2015, the System had goodwill and intangible assets, net, of \$136,661,000 and \$154,958,000, respectively.

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

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, 2014	\$ 124,545	\$ —	\$ 12,423
Assets acquired	20,803	—	3,732
Impairment charges	—	—	—
Amortization	—	—	(4,180)
Currency translation and purchase price adjustments for prior years' acquisitions	(468)	—	(1,897)
Balance at June 30, 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

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 their fair values are greater than their carrying values. 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.

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

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 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.

An impairment loss of \$91,916,000 was recognized in fiscal year 2016 as a result of performing the quantitative analyses. 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. The fair value of the reporting unit was estimated following the process described above using a combination of a discounted cash flow income method and a market approach considering prices of comparable businesses and recent transactions. No impairment loss was recognized in fiscal year 2015. Accumulated impairment of \$91,916,000 was reported at June 30, 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

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

3. Summary of Significant Accounting Policies (continued)

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 2016 and 2015.

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 2016 and 2015.

Deferred Financing Costs

Deferred financing costs, net of accumulated amortization, included in other assets at June 30, 2016 and 2015, are \$8,964,000 and \$10,252,000, 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 2016 and 2015 was \$617,000 and \$719,000, 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 including net gain on contributions to joint ventures in the accompanying consolidated financial statements.

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

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, 2016	\$ 129,072	\$ 267,631	\$ (224,777)	\$ 171,926
Year ended June 30, 2015	119,846	180,953	(171,727)	129,072

Electronic Health Record Incentive Payments

The American Recovery and Reinvestment Act of 2009 (ARRA) included provisions for implementing health information technology under the Health Information Technology for Economic and Clinical Health Act (HITECH). The provisions were designed to increase the use of electronic health record (EHR) technology and establish the requirements for a Medicare and Medicaid incentive payment program beginning in 2011 for eligible providers that adopt and

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

3. Summary of Significant Accounting Policies (continued)

meaningfully use certified EHR technology. Eligibility for annual Medicare incentive payments is dependent on providers demonstrating meaningful use of EHR technology in each period over a four-year period. Initial Medicaid incentive payments are available to providers that adopt, implement, or upgrade certified EHR technology. Providers must demonstrate meaningful use of such technology in subsequent years to qualify for additional Medicaid incentive payments.

CHRISTUS accounts for HITECH incentive payments under the gain contingency model as grants related to income. Income from Medicare incentive payments is recognized as revenue after CHRISTUS has determined it is reasonably assured to comply with the meaningful use criteria over the entire applicable compliance period and the cost report period that will be used to determine the final incentive payment has ended. CHRISTUS recognized revenue from Medicaid incentive payments after it adopted certified EHR technology. Incentive payments totaling \$8,830,000 and \$14,205,000 for the years ended June 30, 2016 and 2015, respectively, are included in other revenue in the accompanying consolidated statements of operations and changes in net assets. Income from incentive payments is subject to retrospective adjustment as the incentive payments are calculated using Medicare cost report data that is subject to audit. In addition, CHRISTUS's compliance with the meaningful use criteria is subject to audit by the federal government.

Premium Revenue and Associated Costs

Premium revenue largely represents revenues derived under capitated arrangements with third parties. In return for these premiums, the 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 US Family Health Plan. Premium revenue recognized under the contract with the DOD was 72.7% and 87.4% of total premium revenue at June 30, 2016 and 2015, 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.

Costs for providing services through these contracts, including services provided by other health care providers, were \$157,040,000 and \$131,251,000 for the years ended June 30, 2016 and 2015, respectively, and are included as operating expenses in the accompanying consolidated financial statements. At June 30, 2016 and 2015, 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.

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

3. Summary of Significant Accounting Policies (continued)

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; EHR incentive payments; 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, snack bars, newsstands, parking lots, vending machines, or other service facilities operated by the health care organization.

Income Taxes

The authoritative guidance in ASC Topic 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, is dependent on circumstances existing if and when remittance occurs. There are no material unrecorded tax liabilities as of June 30, 2016 and 2015.

At June 30, 2016 and 2015, CHRISTUS has operating loss carryforwards of \$108,618,000 and \$106,339,000, which result in deferred tax assets of \$38,016,000 and \$37,219,000, 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.

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

3. Summary of Significant Accounting Policies (continued)

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 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.

New and Pending Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, *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 not 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, *Consolidation (Topic 810)*, 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. ASU 2015-02 is effective for fiscal years and interim periods within those fiscal

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

3. Summary of Significant Accounting Policies (continued)

years, beginning after December 15, 2015, with early adoption permitted. The adoption of the guidance is not expected to have a material impact to the System's consolidated financial statements.

In April 2015, the FASB issued ASU 2015-05 as an update to Subtopic 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 US GAAP resulting in diversity in practice. The amendments in the update provide guidance to customers 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 will be effective for annual periods beginning after December 15, 2015, and interim periods in annual periods beginning after December 15, 2016. Early adoption is permitted. The guidance can be adopted either (1) prospectively to all arrangements entered into or materially modified after the effective date or (2) retrospectively. The adoption of the guidance is not expected to 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 Subtopic 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. Early adoption of the guidance is permitted. 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 updated guidance will result in a re-class of the deferred debt issuance costs in Other Assets to Long Term Debt. No other material impact is expected.

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

3. Summary of Significant Accounting Policies (continued)

In May 2015, the FASB issued ASU 2015-07, *Fair Value Measurements (Topic 820) Disclosure for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*, an update to ASC 820, *Fair Value Measurements*. ASU 2015-07 removed the requirement to categorize within the fair value hierarchy investments for which fair value is measured at net asset value (NAV) using the practical expedient. ASU 2015-07 is to be applied retrospectively and is effective for financial statements issued for fiscal years beginning after December 15, 2016, although early adoption is permitted. ASU 2015-07 provides disclosure guidance only and will have no impact on the System's consolidated financial position or results of operations. The System elected to early adopt ASU 2015-07 as of June 30, 2016. There was no material impact to the System's consolidated financial statements resulting from the implantation of ASU 2015-07.

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*, to require 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.

Reclassifications

Certain prior-year amounts have been reclassified to conform to the current-year presentation. The System reclassified approximately \$9,583,000 in reimbursements of costs under collaboration arrangements from other revenue to operating expenses. The System also reclassified \$10,078,000 of intangible assets from other assets to goodwill and intangible assets, net.

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

3. Summary of Significant Accounting Policies (continued)

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.

Operating and Nonoperating Activities

CHRISTUS Health's 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 the furtherance of 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 Health's primary mission are considered to be nonoperating. Nonoperating 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, 2016 and 2015, 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.

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

4. Net Patient Service Revenue (continued)

For fiscal years 2016 and 2015, revenue increased approximately \$26,571,000 and \$21,901,000, 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 21% and 7%, respectively, of the System's net patient revenue for the fiscal year ended June 30, 2016, and 22% and 9%, respectively, of the System's net patient revenue for the fiscal year ended June 30, 2015. 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.

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 46% and 8%, respectively, of the System's net patient revenue for the fiscal year ended June 30, 2016, and 47% and 8%, respectively, of the System's net patient revenue for the fiscal year ended June 30, 2015.

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):

	2016 Patient Service Revenue		2015 Patient Service Revenue	
		% of Total		% of Total
Medicare	\$ 755,412	21.0%	\$ 764,172	22.4%
Medicaid	249,614	7.0	318,598	9.3
Managed care	1,648,970	46.0	1,588,168	46.5
Commercial	286,523	8.0	285,886	8.4
Self-pay and other	644,992	18.0	457,868	13.4
Grand total	\$ 3,585,511	100.0%	\$ 3,414,692	100.0%

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

4. Net Patient Service Revenue (continued)

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.” DSH 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.

In December 2010, the State of Louisiana adopted a Medicaid State Plan Amendment under which CHRISTUS Health’s 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: the Uncompensated Care Pool (UC) and the Delivery System Reform Incentive Pool (DSRIP). Both pools replace the former UPL in Texas. CHRISTUS has operations in six different regional health partnerships under the 1115(b) waiver program and has approximately 52 DSRIP projects that are eligible for funding to CHRISTUS hospitals. The waiver program was scheduled to expire on September 30, 2016; however, CMS has approved a 15 month extension that will end December 31, 2017. September 30, 2015, marked the completion of the fourth 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 2015 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 31, 2016. Additionally, the 2016 DSH and UC tools have been completed and will be used in finalizing DSH and UC payments for the fifth demonstration year that ends September 31, 2016.

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

4. Net Patient Service Revenue (continued)

In fiscal years 2016 and 2015, the System recorded \$66,312,000 and \$58,392,000, respectively, in net patient service revenue related to the DSRIP program. Additionally, \$163,410,000 and \$233,150,000 was in net patient service revenue in fiscal years 2016, and 2015, respectively, related to the DSH, UC, and UPL programs.

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 financial statements.

In addition, government agencies may review our 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 our 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.

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

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):

	2016	2015
Cash and cash equivalents	\$ 643,993	\$ 463,354
Certificates of deposit	20,822	4,422
Domestic equities	89,967	95,492
International equities	24,288	27,369
Fixed-income securities	119,822	134,326
U.S. government securities	191,465	259,148
Mutual funds and exchange-traded funds:		
Domestic equity funds	156,686	68,638
International equity funds	76,331	34,034
Fixed-income funds	296,408	186,334
Risk parity, blended and other funds	10,936	—
Equity in managed funds:		
Fixed-income funds	133,343	184,685
Hedge funds	260,444	323,742
Private equity, real estate, and other	7,121	7,788
	\$ 2,031,626	\$ 1,789,332

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.

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

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.

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CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

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, 2016 and 2015, the System had commitments to fund equity investments in private equity funds totaling \$6,581,000 and \$4,887,000, respectively, excluding commitments to fund equity investments in private equity funds held by the CHRISTUS Cash Balance Plan (see Note 11).

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

5. Cash and Investments (continued)

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

	2016	2015
Assets whose use is limited or restricted, required for current bond indenture and self-insurance liabilities	\$ 58,387	\$ 49,802
Other investments, internally designated for capital expansion and other purposes	542,228	333,399
Under bond indenture agreement – held by trustee	68,966	55,647
Under liability retention and self-insurance funding arrangement – held by trustee	31,076	14,804
Under Emerald Assurance funding arrangements	183,187	181,174
Restricted cash and investments	43,628	49,532
Total assets whose use is limited or restricted	\$ 927,472	\$ 684,358

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):

	2016	2015
Operating interest and dividend income	\$ 5,658	\$ 9,637
Operating gain, realized and unrealized	2,562	897
Equity investment loss on managed funds	(2,767)	(845)
Total operating investment income	5,453	9,689
Non-operating interest and dividend income	10,525	9,655
Non-operating gain, realized and unrealized	7,041	13,540
Equity investment loss on managed funds	(16,101)	(11,044)
Net swap agreement activity	(73,038)	(32,035)
Total non-operating investment loss	(71,573)	(19,884)
Total investment loss	\$ (66,120)	\$ (10,195)

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

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, 2016 and 2015.

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

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):

	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				<u>\$ 1,718,697</u>
Liabilities				
Interest rate swap agreements	\$ —	\$ 168,520	\$ —	\$ 168,520
Total liabilities at fair value	\$ —	\$ 168,520	\$ —	<u>\$ 168,520</u>

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

6. Fair Value Measurements (continued)

During the year ended June 30, 2016, long-lived assets held and used with a carrying amount of \$31,117,000 were written down to their fair value of \$0, resulting in an impairment charge of \$31,117,000. Fair value was estimated primarily using an internally-developed discounted cash flow income approach, a Level 3 input. Also during the year ended June 30, 2016, goodwill of \$91,916,000 was written down to its implied fair value of \$0, resulting in an impairment charge of \$91,916,000. Fair value was estimated using a combination of an internally-developed discounted cash flow income approach and a market approach that considered prices of comparable businesses, transactions, and specific assets of the reporting unit, which was considered a Level 3 measurement.

	2015			
	Level 1	Level 2	Level 3	Total
Assets				
Investments:				
Cash and cash equivalents	\$ 463,354	\$ —	\$ —	\$ 463,354
Certificates of deposit	—	4,422	—	4,422
Domestic equities	95,492	—	—	95,492
International equities	27,369	—	—	27,369
Fixed-income securities	—	134,327	—	134,327
U.S. government securities	—	259,148	—	259,148
Mutual and exchange-traded funds:				
Domestic equity funds	47,147	—	—	47,147
International equity funds	34,034	—	—	34,034
Fixed income funds	83,223	—	—	83,223
	<u>\$ 750,619</u>	<u>\$ 397,897</u>	<u>\$ —</u>	<u>1,148,516</u>
Investments measured at net asset value or equivalent:				
Equity funds				21,491
Fixed-income funds				128,511
Hedge funds				63,713
Private equity, real estate and other funds				7,788
Total assets at fair value				<u>\$ 1,370,019</u>
Liabilities				
Interest rate swap agreements	\$ —	\$ 109,172	\$ —	\$ 109,172
Total liabilities at fair value	<u>\$ —</u>	<u>\$ 109,172</u>	<u>\$ —</u>	<u>\$ 109,172</u>

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

6. Fair Value Measurements (continued)

As noted previously, the System elected to early adopt ASU 2015-07 as of June 30, 2016. Accordingly, investments measure at fair value using net asset value per share or its equivalent as a practical expedient, as permitted by ASC 820-10 *Fair Value Measurement and Disclosures*, have not been categorized within the fair value hierarchy in the tables above. The fiscal year 2015 table has been revised to conform to the 2016 presentation.

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 \$312,929,000 and \$419,313,000 at June 30, 2016 and 2015, 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, 2016 and 2015, 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.

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

6. Fair Value Measurements (continued)

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, approximates \$563,867,000 compared to its carrying value of \$513,615,000 at June 30, 2016. 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.

At June 30, 2016, 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):

	<u>2016</u>	<u>2015</u>
Land	\$ 199,456	\$ 165,807
Land improvements	70,457	65,956
Buildings and fixed equipment	2,513,418	2,147,073
Major movable equipment	1,612,874	1,522,489
Accumulated depreciation	<u>(2,598,356)</u>	<u>(2,482,087)</u>
	1,797,849	1,419,238
Construction-in-progress (estimated cost to complete is \$425 million and \$400 million at June 30, 2016 and 2015, respectively)	<u>142,334</u>	<u>124,511</u>
Total	<u><u>\$ 1,940,183</u></u>	<u><u>\$ 1,543,749</u></u>

Depreciation expense for the System for fiscal years 2016 and 2015 totaled \$196,986,000 and \$164,695,000, respectively. The 2016 total includes \$31,117,000 of impairment charges discussed above.

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

8. Investments in Unconsolidated Organizations

The System has investments in unconsolidated organizations of \$148,095,000 and \$148,805,000 at June 30, 2016 and 2015, respectively. Differences between the carrying amounts of the System's investments and the underlying equity in the net assets of the investees total approximately \$51,692,000 at both June 30, 2016 and 2015, which relates primarily to equity method goodwill. The following investments account for 86% and 93% of the System's total investments in unconsolidated organizations in both 2016 and 2015, respectively:

Houston Methodist St. John Hospital

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 Gulf Coast maintains a 30% non-controlling interest. CHRISTUS's recorded investment, accounted for under the equity method, was \$29,007,000 and \$29,615,000 at June 30, 2016 and 2015, respectively. The System's share of (loss) income was (\$608,000) and \$510,000 for the years ended June 30, 2016 and 2015, respectively. Subsequent to June 30, 2016, CHRISTUS Health executed a sale of the 30% interest to Methodist Health Centers.

Houston Methodist St. Catherine Real Property Company

On January 31, 2014, 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, Gulf Coast has a 30% non-controlling membership interest in HMSCRE. Prior to this date, the assets and operations of CHRISTUS St. Catherine were consolidated in the accompanying consolidated financial statements. CHRISTUS's recorded investment, accounted for under the equity method, was \$14,040,000 at both June 30, 2016 and 2015. The System's share of income from operations is de minimis. Subsequent to June 30, 2016, CHRISTUS Health executed a sale of the 30% interest to Methodist Health Centers.

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

8. Investments in Unconsolidated Organizations (continued)

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. CHRISTUS' recorded investment, accounted for under the equity method, was \$10,725,000 and \$20,109,000 at June 30, 2016 and 2015, respectively. PUC refunded \$10,000,000 of the purchase price in 2016 and CHRISTUS made an \$836,000 capital contribution. The System's share of losses for the years ended June 30, 2016 and 2015, was \$220,000 and \$312,000, respectively. There is additional discussion of the System's international operations in Note 18.

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 Inmobiliaria Clinica San Carlos de Apoguindo S.A. (jointly referred to as "San Carlos"). CHRISTUS's recorded investment, accounted for under the equity method, was \$68,159,000 and \$68,255,000 at June 30, 2016 and 2015, respectively. The System's share of (losses) earnings for the years ended June 30, 2016 and 2015, was (\$95,000) and \$534,000, respectively. There is additional discussion of the System's international operations in Note 18.

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 Health's recorded investment, accounted for under the equity method, was \$6,798,000 and \$5,665,000 at June 30, 2016 and 2015, respectively. The System recorded its share of income from operations in fiscal years 2015 and 2014 of \$967,000 and \$829,000, respectively.

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, 2016 and 2015, respectively.

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

9. Long-Term Debt

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

	<u>2016</u>	<u>2015</u>
Obligations issued under the CHRISTUS Health Master Trust Indenture:		
Revenue bonds, in variable-rate demand mode, with weighted-average interest rates of 0.14% and 0.05% in fiscal 2016 and 2015, respectively, due in annual installments through July 1, 2047	\$ 225,885	\$ 225,885
Revenue bonds, in auction mode, with weighted-average interest rates of 0.47% and 0.52% in fiscal 2016 and 2015, respectively, due in annual installments through July 1, 2031	165,500	174,100
Revenue bonds, in fixed-rate mode, bearing interest from 4.00% to 6.50%, due in annual installments through July 1, 2035	374,820	393,115
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, in fixed-rate mode, bearing interest at 2.15%, due in annual installments through July 1, 2020	30,000	—
Direct-placement note, in variable-rate mode, bearing interest at 67% of London Interbank Offered Rate (LIBOR) plus 1.85% (weighted average interest rate of 2.07% in fiscal 2016,) due in annual installments through July 1, 2022	12,467	—
Bank note, in fixed-rate mode, bearing interest at 4.25%, due in monthly installments through April 1, 2029	7,539	—
Other long-term debt obligations:		
Capital leases for certain hospital facilities, bearing interest at fixed rates ranging from 6.0% to 6.9%, with annual principal payments through 2030, secured by the related assets	44,414	47,113
Other notes and capital lease obligations	35,318	48,990
	<u>1,034,738</u>	<u>889,203</u>
Premiums and (discounts) on long-term debt	759	(9,358)
	<u>1,035,497</u>	<u>879,845</u>
Less current portion, including amounts subject to remarketing agreements	(55,815)	(77,062)
Total	<u>\$ 979,682</u>	<u>\$ 802,783</u>

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

9. Long-Term Debt (continued)

According to the terms of the CHRISTUS Health Master Trust Indenture (CHRISTUS MTI), the Obligated Group consists of CHRISTUS Health and eight of the System's regions as follows: CHRISTUS Spohn Health System, CHRISTUS Health Gulf Coast, CHRISTUS Health Southeast Texas, CHRISTUS Santa Rosa Health Care Corporation, CHRISTUS Health Ark-La-Tex, CHRISTUS Health Northern Louisiana, CHRISTUS Health Central Louisiana, and CHRISTUS Health Southwestern Louisiana.

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 Health Liability Retention Trust, Emerald Assurance, CHRISTUS Trinity Mother Frances, CHRISTUS St. Vincent Regional Medical Center, CHRISTUS Physician Group, CHRISTUS Continuing Care, CHRISTUS St. Michael Atlanta, 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 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 Trinity Mother Frances are subject to the terms of the Mother Frances Hospital Regional Health Care Center Trust Indenture (MFH MTI). According to the MFH MTI, Mother Frances Hospital Regional Health Care Center is the sole member of the Obligated Group. The MFH MTI and loan agreements require that certain funds be established with a trustee; and that the members of the Obligated Group comply with certain covenants, including minimum insurance coverage, to maintain a sufficient debt service coverage, to maintain a required level of days cash on hand, restrictions on incurrence of additional debt, and restrictions on the disposition of assets or transfers of assets out of the Obligated Group.

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

9. Long-Term Debt (continued)

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 October 3, 2017. 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 October 2, 2017. 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 June 2016, CHRISTUS entered into a transaction to legally cash defease outstanding municipal debt totaling \$6,850,000 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, 2016.

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

2017	\$ 55,815
2018	46,811
2019	54,069
2020	52,928
2021	43,786
Thereafter	781,329
Total debt	<u>\$ 1,034,738</u>

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

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

10. Derivative Financial Instruments (continued)

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 2016 and 2015, CHRISTUS has interest rate swap agreements to manage interest rate risk exposure, not designated as hedging instruments, with a total notional amount of \$929,685,000 and \$938,110,000, respectively.

The following tables summarize the fair value at June 30, 2016 and 2015, and the income (loss) recorded related to the interest rate swap agreements as of and for the years ended June 30, 2016 and 2015, (in thousands).

Counterparty Description	Termination Date	Interest Rate Agreements	Notional Amount	Fair Value		Change in Fair Value		(Paid)/Received	
				June 30, 2016	June 30, 2015	June 30, 2016	June 30, 2015	June 30, 2016	June 30, 2015
Merrill Lynch	Variable Basis	2021-2023	6	\$ 470,000	\$ (1,380)	\$ 1,739	\$ (3,119)	\$ 4,824	\$ 640
Wells Fargo	Fixed Payor	2031	1	180,425/188,850	(32,150)	(24,411)	(7,739)	(1,100)	(5,378)
Citigroup*	Fixed Payor	2047	2	166,100	(80,558)	(51,770)	(28,788)	(12,548)	(5,347)
Citigroup*	Fixed Payor	2047	1	113,160	(54,432)	(34,730)	(19,702)	(8,538)	(3,604)
				<u>\$929,685/938,110</u>	<u>\$(168,520)</u>	<u>\$(109,172)</u>	<u>\$(59,348)</u>	<u>\$ (17,362)</u>	<u>\$(13,689)</u>

*Insured by MBIA

CHRISTUS is required to post collateral for negative valuations on each of its swaps according to the terms of (i) the swap insurance agreements, where applicable and (ii) the agreement with each counterparty. CHRISTUS has complied with this requirement. At June 30, 2016 and 2015, no collateral was posted. The System does not anticipate non-performance by its counterparties.

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

10. Derivative Financial Instruments (continued)

The fair value of these swap agreements was a liability of \$168,520,000 and \$109,172,000 at June 30, 2016 and 2015, respectively. The change in fair value of (\$59,348,000) and (\$17,362,000) for the years ended June 30, 2016 and 2015, respectively, is combined with the payments, net of receipts made under the agreements, of \$13,690,000 and \$14,673,000 for the years ended June 30, 2016 and 2015, respectively. This total is included in non-operating investment gain (loss) in the accompanying 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.

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

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
	2016	2015	2016
Service cost	\$ 18,682	\$ 21,047	\$ —
Interest cost	38,174	37,387	1,471
Expected return on assets	(49,903)	(51,332)	(1,208)
Amortization of prior service credit	(11,884)	(12,171)	—
Recognized net actuarial loss	13,180	10,353	—
Net benefit cost	<u>\$ 8,249</u>	<u>\$ 5,284</u>	<u>\$ 263</u>

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
	2016	2015	2016
Changes in benefit obligation			
Benefit obligation – beginning of year	\$ 898,533	\$ 897,510	\$ —
TMF benefit obligation acquired	—	—	221,077
Service cost	18,682	21,047	—
Interest cost	38,174	37,387	1,471
Actuarial loss (gain)	18,768	(11,473)	7,784
Benefits paid	(46,420)	(45,938)	(887)
Benefit obligation – end of year	<u>\$ 927,737</u>	<u>\$ 898,533</u>	<u>\$ 229,445</u>

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

11. Employee Benefit Plans (continued)

	Cash Balance Plan		TMF Plan
	2016	2015	2016
Changes in plan assets			
Fair value of plan assets – beginning of year	\$ 850,190	\$ 868,509	\$ –
TMF plan assets acquired	–	–	140,847
Actual return on plan assets	(12,201)	9,619	3,314
Employer contributions	13,000	18,000	1,500
Benefits paid	(46,420)	(45,938)	(887)
Fair value of plan assets – end of year	<u>\$ 804,569</u>	<u>\$ 850,190</u>	<u>\$ 144,774</u>
 Funded status	 <u>\$ (123,168)</u>	 <u>\$ (48,343)</u>	 <u>\$ (84,671)</u>
 Amounts recognized in unrestricted net assets:			
Unrecognized net actuarial loss	\$ 249,803	\$ 182,111	\$ 5,678
Unrecognized prior service credit	(35,677)	(47,560)	–
Total recognized in unrestricted net assets	<u>\$ 214,126</u>	<u>\$ 134,551</u>	<u>\$ 5,678</u>

Amounts recognized in unrestricted net assets expected to be recognized in net periodic benefit cost for the Defined Benefit Plans during fiscal 2017 are \$10,549,000.

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

	Cash Balance Plan		TMF Plan
	2016	2015	2016
Net actuarial gain	\$ 80,871	\$ 30,240	\$ 5,678
Amortization of net actuarial loss	(13,180)	(10,353)	–
Amortization of prior service credit	11,884	12,171	–
Total changes recognized in unrestricted net assets	<u>\$ 79,575</u>	<u>\$ 32,058</u>	<u>\$ 5,678</u>

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

11. Employee Benefit Plans (continued)

As of June 30, 2016 and 2015, the Defined Benefit Plans had accumulated benefit obligations of \$1,152,168,000 and \$894,211,000, respectively. Assumptions used to determine benefit obligations and net periodic benefit cost for the fiscal years were as follows:

	Cash Balance Plan		TMF Plan
	2016	2015	2016
Benefit obligations:			
Discount rate	3.54%	4.37%	3.85%
Rate of compensation increase	3.71	3.71	N/A
Net periodic benefit cost:			
Discount rate	4.37	4.27	4.07
Expected long-term return on plan assets	6.00	6.00	5.25
Rate of compensation increase	3.71	4.09	N/A

Investment Policy and Asset Allocations

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.

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

11. Employee Benefit Plans (continued)

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

	2016	2015
Cash and cash equivalents	\$ 29,056	\$ 57,467
Domestic equities	37,183	36,676
International equities	23,845	26,204
Mutual funds and exchange-traded funds:		
Domestic equity funds	39,169	26,875
International equity funds	40,081	45,512
Fixed-income funds	62,840	60,417
Equity investments in managed funds:		
Fixed-income funds	301,671	288,888
Hedge funds	134,441	179,962
Private equity, real estate, and other	135,068	127,363
Other	1,215	826
Total	<u>\$ 804,569</u>	<u>\$ 850,190</u>

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

	2016	2015
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 (<i>Note 5</i>)	55	55
Total	<u>100%</u>	<u>100%</u>

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

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
	<u>233,389</u>	<u>—</u>	<u>—</u>	<u>233,389</u>
Investments measured at net asset value or equivalent:				
Fixed-income funds				301,671
Hedge funds				134,441
Private equity, real estate, and other funds				<u>135,068</u>
Total assets at fair value				<u>\$ 804,569</u>

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

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, 2015, as follows (in thousands):

	Level 1	Level 2	Level 3	Total
Assets				
Investments:				
Cash and cash equivalents	\$ 57,467	\$ —	\$ —	\$ 57,467
Domestic equities	36,676	—	—	36,676
International equities	26,204	—	—	26,204
Mutual funds and exchange-traded funds:				
Domestic equity funds	26,875	—	—	26,875
International equity funds	45,512	—	—	45,512
Fixed-income funds	60,417	—	—	60,417
Other	826	—	—	826
	<u>253,977</u>	<u>—</u>	<u>—</u>	<u>253,977</u>
Investments measured at net asset value or equivalent:				
Fixed-income funds				288,888
Hedge funds				179,962
Private equity, real estate, and other funds				<u>127,363</u>
Total assets at fair value				<u>\$ 850,190</u>

As noted previously, the System elected to early adopt ASU 2015-07 as of June 30, 2016. Accordingly, investments measured at fair value using net asset value per share or its equivalent as a practical expedient, as permitted by ASC 820-10, have not been categorized within the fair value hierarchy in the tables above. The fiscal year 2015 table has been revised to conform to the 2016 presentation.

The cash balance plan has \$71,079,000 of funding commitments to purchase equity investments in managed funds as of June 30, 2016.

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

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, which 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 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 Texas Hospital Association Retirement Trust, the trustees developed asset mix targets, which 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, 2016:

	<u>Actual</u>	<u>Target</u>
Equity securities	55%	55%
Fixed-income securities	44	44
Cash and cash equivalents	1	1
	<u>100%</u>	<u>100%</u>

Contributions

In fiscal year 2017, CHRISTUS expects to contribute \$22,500,000 to the Defined Benefit Plans based on asset values for the plan year beginning January 1, 2016. Contributions to the cash balance plan of \$13,000,000, and \$18,000,000 were made for plan years beginning January 1, 2016 and 2015, respectively, and contributions to the TMF Plan of \$1,500,000 were made during fiscal year 2016.

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

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
2017	\$ 52,375	\$ 6,599
2018	54,405	7,102
2019	55,170	7,603
2020	56,115	8,197
2021	57,782	8,813
Years 2022–2026	296,788	52,130

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 that had not vested as of that date are not eligible for the postretirement health care benefits. The liability associated with the postretirement plan will be reduced as employee participation decreases. Net benefit cost (credit) under the postretirement plan was \$(5,119,000) and \$(466,000) for the years ended June 30, 2016 and 2015. The net benefit obligation was \$17,764,000 and \$23,440,000 at June 30, 2016 and 2015, respectively, which is included in accrued pension benefits on the accompanying balance sheets. The postretirement plan is unfunded.

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

11. Employee Benefit Plans (continued)

Simplified Early Retirement Plan (SERP)

Prior to the formation of CHRISTUS, a plan for executives was curtailed prospectively. Under this plan, eligible participants receive a cash benefit payment until death and participate in the System's retiree health, dental and group term life program. Fewer than two dozen participating retirees currently maintain benefit payment status. Benefits are recalculated when participants attain the age of 65 and remain constant thereafter. Net benefit cost (credit) under the SERP was \$(282,000) and \$310,000 for the years ended June 30, 2016 and 2015, respectively. The net benefit obligation was \$4,701,000 and \$4,983,000 at June 30, 2016 and 2015, respectively, which is included in accrued pension benefits on the accompanying balance sheets. The SERP is unfunded.

Restoration Plan

The restoration plan, a non-qualified, deferred compensation plan, was designed to restore benefits that are lost under the cash balance plan due to the statutory limit on recognizable compensation. Eligibility is limited to designated executives. The plan provides benefits upon termination of employment to qualifying participants. Plan benefits are calculated using the same methodology for the cash balance plan; vesting requirements are also the same. The restoration plan was frozen at December 31, 2013. Net benefit cost under the restoration plan was \$297,000 and \$309,000 for the years ended June 30, 2016 and 2015, respectively. The net benefit obligation was \$1,834,000 and \$2,282,000 at June 30, 2016 and 2015, respectively, which is included in accrued pension benefits on the accompanying balance sheets. The restoration plan is unfunded.

Defined-Contribution Plans

403(b) Matched Savings Plans

The System has a defined-contribution plan (the Matched Savings Plan) covering substantially all CHRISTUS employees. Annual employee contributions are limited to 50% of compensation, up to the 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, 2016 and 2015, expenses attributable to the Matched Savings Plan amounted to \$12,333,000 and \$12,652,000, respectively.

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

11. Employee Benefit Plans (continued)

CHRISTUS St. Vincent Regional Medical Center (St. Vincent) has two 403(b) defined-contribution plans for bargaining and non-bargaining employees. St. Vincent contributes 4.0% 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 on a bi-weekly basis. For fiscal years 2016 and 2015, St. Vincent has incurred approximately \$3,897,000 and \$3,643,000 in expenses related to the plans, respectively.

ExecuFLEX Benefit Plan

The ExecuFLEX plan was originally established by Sisters of Charity of the Incarnate Word Houston, Texas, effective January 1, 1995. Sponsorship of the plan was then transferred to and assumed by CHRISTUS Health, effective February 1, 1999. The plan was limited to designated executives. Plan participants received an ExecuFLEX allowance to be allocated among four different components: CHRISTUS Health ExecuFLEX Individual Long-Term Disability Plan, CHRISTUS Health ExecuFLEX Supplemental Survivor Plan, CHRISTUS Health ExecuFLEX Spouse Survivor Plan, and CHRISTUS Health ExecuFLEX Deferred Income Account Plan (DIA Plan). The ExecuFLEX plan was frozen at December 31, 2013.

The DIA Plan was a non-qualified, deferred compensation plan; eligibility was limited to designated executives. Benefits vest based on certain qualifying events and are paid to participants when fully vested. The funds contributed by participants to this component of the ExecuFLEX Plan 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, 2016 and 2015, the total asset and corresponding liability related to the DIA Plan were \$2,423,000 and \$3,662,000, respectively. As a component of the ExecuFLEX plan, this plan was frozen at December 31, 2013.

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 Health 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 Health. The DC SERP also includes provisions for a deferred compensation plan. As of June 30, 2016 and 2015, the asset and corresponding liability balances recorded related to the DC SERP were \$22,191,000 and \$15,686,000, respectively. CHRISTUS Health incurred expense of \$15,181,000 and \$15,800,000 related to the DC SERP in fiscal years 2016 and 2015, respectively.

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

12. Self-Funded Liabilities

The System self-funds and self-insures for primary professional and general liability, workers' compensation and Texas occupational injury, directors & 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 & 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 2016 and 2015. For general liability, policies written provide coverage with primary limits in the amount of \$2,000,000 per claim for fiscal years 2016 and 2015. Additionally, the System internally sets aside funds for workers' compensation, Texas occupational injury program, and employee medical benefits based on actuarial analyses.

CHRISTUS Trinity Mother Frances Health System (TMF), which was acquired by the System on May 1, 2016, continues to maintain a separate insurance program covering all coverages except directors & officers' liability, employment practices liability and property insurance, which were merged into the System program on May 1. TMF is self-insured for the first \$3,000,000 of each medical malpractice claim, and maintains and funds 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 also is a Texas Certified Self-Insurer for workers' compensation and sets aside funds for workers' compensation and employee medical benefits. Commercial insurance policies cover other risk exposures, including ambulance and auto liability, aviation liability, cyber liability, and excess professional, general and workers' compensation liability.

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.

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

12. Self-Funded Liabilities (continued)

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:

	2016	2015
Medicare	30.4%	20.7%
Medicaid	7.4	6.8
Managed care organizations	29.2	39.2
Commercial insurance	5.6	7.9
Self-pay	15.3	14.1
Others	12.1	11.3
	100.0%	100.0%

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 2016 and 2015 for all operating leases was approximately \$59,806,000 and \$52,360,000, respectively.

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

14. Commitments and Contingencies (continued)

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, 2016, that have initial or remaining lease terms in excess of one year (in thousands):

2017	\$ 51,022
2018	43,239
2019	35,642
2020	30,303
2021	26,890
Thereafter	16,256
Total	<u>\$ 203,352</u>

Capital Commitments

As of June 30, 2016, the System has committed to fund approximately \$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.

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 received notice that hospitals in several regions have been identified as part of the nationwide Department of Justice (DOJ) investigation to determine whether, in certain cases, implantable cardioverter defibrillators (ICD) were provided to certain Medicare beneficiaries in accordance with national coverage criteria. The System reached a settlement with the DOJ related to this matter in fiscal year 2015 for an amount that did not materially impact the financial statements.

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

14. Commitments and Contingencies (continued)

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 Health 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 our 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):

	2016	2015
Health care services	\$ 2,998,698	\$ 2,648,542
Physician services	305,630	254,175
General and administrative	608,155	641,151
Total	\$ 3,912,483	\$ 3,543,868

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

16. Temporarily and Permanently Restricted Net Assets

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

	<u>2016</u>	<u>2015</u>
Purchase of equipment/capital improvement	\$ 22,545	\$ 16,957
Indigent care	240	344
Health education	2,667	2,612
Health care services	108,265	107,468
Community outreach	11,445	12,615
Other	17,823	15,683
Total	<u>\$ 162,985</u>	<u>\$ 155,679</u>

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

	<u>2016</u>	<u>2015</u>
Investments to be held in perpetuity, the income from which is expendable to support health care services (reported as operating income)	\$ 6,807	\$ 6,677
Endowment requiring income to be added to original gift	3,129	1,136
Other	6,941	6,950
Total	<u>\$ 16,877</u>	<u>\$ 14,763</u>

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

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, 2014	\$ 2,502,684	\$ 126,789	\$ 2,629,473
Revenues in excess of expenses	13,269	22,581	35,850
Distributions	—	(5,005)	(5,005)
Acquisition of non-controlling interest	—	(3,500)	(3,500)
Change in pension liabilities	(31,790)	—	(31,790)
Other activities	(17,332)	(3,838)	(13,494)
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	<u>\$ 2,599,043</u>	<u>\$ 152,802</u>	<u>\$ 2,751,845</u>

18. International Operations

CHRISTUS Muguerza

At June 30, 2016, the System owned an 85.3% 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 consolidated in the CHRISTUS consolidated financial statements. CHRISTUS Muguerza has net assets of \$97,217,000 and \$99,360,000 at June 30, 2016 and 2015, respectively.

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

18. International Operations (continued)

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 will 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, 2016 and 2015, respectively, the System had \$5,539,000 and \$5,293,000 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 10,205,401 shares put forth by the non-controlling shareholders in accordance with the agreement during 2016, the System increased its ownership interest in CHRISTUS Muguerza from 79.2% to 85.3%, for cash consideration of \$10,000,000. During the year ended June 30, 2015, the System acquired 3,477,596 shares from non-controlling shareholders for cash consideration of \$3,500,000.

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.

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 Servicios Clinicos San Carlos Apoquindo S.A. and Inmobiliaria 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.

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

18. International Operations (continued)

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. Of this amount, \$8,407,000 was received during the year ended June 30, 2016, and the remaining \$1,593,000 was received in August 2016.

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 a series of agreements, including a shareholders' agreement and an integration agreement (the PUC Agreements), that modifies and finalizes 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. The second closing is expected to occur prior to December 31, 2016, and the final closing is expected to occur prior to December 31, 2017. 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 \$152,000,000.

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, Ltd, a wholly-owned subsidiary of CHRISTUS Health, 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 2016. 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. At June 30, 2016 and 2015, accrued interest related to the

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

18. International Operations (continued)

note was \$1,627,000 and \$605,000, respectively. The note is convertible into additional capital contributions as outlined in the PUC Agreements. The note is reported within other noncurrent assets in the accompanying 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 \$7,173,000 and \$7,492,000 during 2016 and 2015, respectively.

19. Significant Events

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.

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

19. Significant Events (continued)

In accordance with ASC 958-805, *Not-for-profit Entities (Topic 958)* 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:

	<u>2016</u>
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)
Fair values of assets acquired and liabilities assumed	<u>492,009</u>
Inherent contribution	<u>\$ 492,009</u>
Classification of inherent contribution:	
Unrestricted	\$ 478,347
Temporarily restricted	11,258
Permanently restricted	2,404
	<u>\$ 492,009</u>

Existing donor-imposed restrictions on the use of the net assets acquired were retained in purchase accounting. CHRISTUS also incurred approximately \$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.

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

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. Had the acquisition of TMF occurred as of July 1, 2014, the unaudited pro forma total operating revenue and revenues in excess (deficit) of expenses of CHRISTUS would have been \$4,345,193,000 and (\$233,448,000), respectively for the year ended June 30, 2016, and \$4,361,425,000 and \$90,750,000, respectively, for the year ended June 30, 2015. 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.

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 (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 noncontrolling interest	5,189
Total consideration transferred	<u>10,590</u>
Fair values of assets acquired and liabilities assumed:	
Current assets and liabilities, net	596
Property and equipment	1,509
Intangible assets	38
Fair values of assets acquired and liabilities assumed	<u>2,143</u>
Goodwill	<u>\$ 8,447</u>

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

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):

Cash consideration	\$ 10,633
Fair value of noncontrolling interest	6,992
Total consideration transferred	<u>17,625</u>
Fair values of assets acquired and liabilities assumed:	
Current assets and liabilities, net	230
Property and equipment	204
Intangible assets	240
Fair values of assets acquired and liabilities assumed	<u>674</u>
Goodwill	<u><u>\$ 16,951</u></u>

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.

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

19. Significant Events (continued)

Acquisition of Urgent Care of Texas

On February 1, 2015, Ambulatory Strategies Physician Group, a wholly-owned subsidiary of CHRISTUS, acquired 100% of the membership interests in Urgent Care Solutions, LLC and the tangible assets of Urgent Care & Occupational Health Centers of Texas, P.A. (UCT). The transaction was accounted for using the acquisition method of accounting. Total consideration paid for the assets and operations was \$14,481,000, with \$13,581,000 paid at closing and the remaining \$900,000 to be paid in equal annual installments of \$300,000 over the next three years. Based on the final purchase price allocation CHRISTUS recorded approximately \$13,125,000 in goodwill. The goodwill arising from the acquisition consists largely of the economies of scale and synergies expected to be gained from combining the operations of UCT with the System. Acquisition costs related to this transaction, which were recorded as other expenses, were immaterial. The table below summarizes the allocation of the purchase price (including assumed liabilities) for the acquisition of UCT in 2015 (in thousands):

Cash consideration transferred	\$ 14,481
Fair values of assets acquired and liabilities assumed:	
Current assets and liabilities, net	120
Property and equipment	1,019
Intangible assets	420
Other liabilities assumed	(203)
Fair values of assets acquired and liabilities assumed	<u>1,356</u>
Goodwill	<u>\$ 13,125</u>

Total operating revenue and revenues (less than) in excess of expenses during fiscal year 2016 attributable to Velocity Care, CTAEC, and UCT were \$12,189,000 and (\$3,265,000), respectively. On an unaudited pro forma basis, the total operating revenue and revenues in excess of expenses of CHRISTUS would not have changed materially if the acquisitions of Velocity Care, CTAEC, and UCT had occurred as of July 1, 2014.

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

19. Significant Events (continued)

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 2016, the System recorded a gain from the sale of BSAHS of \$16,000,000, resulting from the subsequent distributions of sale proceeds initially deposited into an escrow account. The gain is included in equity income from unconsolidated organizations for the year ended June 30, 2016.

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. As a result of the sale, the System recorded a gain of \$16,359,000 during the year ended June 30, 2015. 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 income from unconsolidated organizations for both the years ended June 30, 2016 and 2015.

20. Subsequent Events

The System evaluated events and transactions occurring subsequent to June 30, 2016, through September 16, 2016, the date of issuance of the 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.

International Operations

As discussed in Note 18, in May 2016, CHRISTUS and PUC executed the PUC Agreements, which contemplate closing on a series of transactions in three separate stages, with the final closing occurring in fiscal year 2018. The first closing occurred on July 15, 2016, at which time CHRISTUS contributed an additional \$14,560,000 to San Carlos. In addition, Amatista executed a loan with PUC for \$20,000,000. PUC also paid the remaining \$1,593,000 owed to CHRISTUS for the purchase price refund in connection with the restructuring of Salud U.C.

CHRISTUS Health

Notes to Consolidated Financial Statements (continued)

20. Subsequent Events (continued)

In September 2016, CHRISTUS closed on a transaction with Cooperativa Medica del Valle Y de Profesionales de Colombia (COOMEVA), in which CHRISTUS paid approximately \$22,200,000 to acquire a 10% non-controlling equity ownership interest in Coomeva Medicina Prepagada SA, which owns and operates a private insurance plan and ambulance services in Colombia, and a 20.8% non-controlling equity ownership interest in Sinergia Global en Salud SAS, a Colombian healthcare provider that owns and operates hospitals, outpatient clinics, and home care services, both of which are controlled by COOMEVA. In addition, CHRISTUS executed a loan with an affiliate of COOMEVA for approximately \$2,600,000

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 (the Hopkins JV). CHRISTUS contributed cash of \$18,448,000 in exchange for a 51% ownership interest in the Hopkins JV, 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 the Hopkins JV. The transaction has been accounted for as an acquisition, for which the purchase price allocation has not yet been finalized.

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 to Methodist Health Centers. On January 31, 2014, CHRISTUS Gulf Coast also contributed the land, building, and improvements of CHRISTUS Health St. Catherine Hospital 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 percent interest rate was signed for the remaining \$21,570,000. Principal and interest on the note is 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.

Supplementary Information

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 16, 2016

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.

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

	2016	2015
	<i>(Unaudited)</i>	
Programs and services for the poor and underserved:		
Charity care at unpaid cost	\$ 215,404	\$ 209,573
Unpaid cost of Medicaid and other public programs	33,549	33,214
Community services for the poor and underserved	65,585	88,849
Total for the poor and underserved	314,538	331,636
Community services for the broader community:		
Education and research	8,450	5,229
Other community services	4,175	5,744
Total for the broader community	12,625	10,973
Total community benefits	\$ 327,163	\$ 342,609

The totals are calculated following CHA guidelines and adhere to 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 2015 has been updated to reflect the change in methodology effective for fiscal year 2016 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 fiscal years ended June 30, 2016 and 2015, the unpaid costs of these programs were \$222,846,000 and \$181,547,000, 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 (DOD) civilian care, included as per the State of Texas guidelines.

Supplementary Information – Federal and State Awards

CHRISTUS Health

Schedule of Compensation Information

Years Ended June 30, 2016 and 2015

Chief Executive Officer: Ernie Sadau

None of the Chief Executive Officer's compensation is paid from public funds received by CHRISTUS Health.

CHRISTUS Health

Schedule of Expenditures of Federal and State Awards

Year Ended June 30, 2016

Federal Grantor/State Grantor/Pass-Through Grantor/Program or Cluster Title	Location	Federal CFDA Number/ State Contract Number	Pass-Through Entity Identifying Number	Expenditures	Amounts Passed Through to Subrecipients
FEDERAL AWARDS					
U.S. Department of Agriculture					
Indirect awards:					
Pass-through the Texas Department of State Health Services:					
Special Supplemental Nutrition Program for Women, Infants, and Children	CHRISTUS Health Santa Rosa	10.557	32-0113643	\$ 1,127,469	\$ 153,372
Total U.S. Department of Agriculture				1,127,469	153,372
U.S. Department of Justice					
Indirect awards:					
Pass-through the New Mexico Crime Victims Reparation Commission: Crime Victim Assistance					
	CHRISTUS St. Vincent Regional Medical Center	16.575	2015-VA-GX-0000	17,857	
Total U.S. Department of Justice				17,857	
U.S. Department of Health and Human Services					
Direct awards:					
Health Care Innovation Awards (HCIA)					
	CHRISTUS Health Ark-La-Tex	93.610		58,128	
Grants for Primary Care Training and Enhancement					
	CHRISTUS Health Santa Rosa	93.884		162,121	
Direct awards total				220,249	
Indirect awards:					
Pass-through the New Mexico Department of Health:					
Hospital Preparedness Program (HPP) and Public Health Emergency Preparedness (PHEP) Aligned Cooperative Agreements					
	CHRISTUS St. Vincent Regional Medical Center	93.074	ASPR15A-032	10,000	
Pass-through Texas Department of State Health Services:					
Centers for Disease Control and Prevention Investigations and Technical Assistance					
	CHRISTUS Health Ark-La-Tex	93.283	32-0113643	22,664	

CHRISTUS Health

Schedule of Expenditures of Federal and State Awards (continued)

Federal Grantor/State Grantor/Pass-Through Grantor/Program or Cluster Title	Location	Federal CFDA Number/ State Contract Number	Pass-Through Entity Identifying Number	Expenditures	Amounts Passed Through to Subrecipients
FEDERAL AWARDS (continued)					
U.S. Department of Health and Human Services (continued)					
Indirect awards (continued):					
Pass-through the American Diabetic Educators Association:					
PPHF: Chronic Disease Innovation Grants – financed solely by Public Prevention Health Funds	CHRISTUS Health Central Louisiana	93.739	51-0161670	\$ 9,121	
Pass-through LSU Health Science Center New Orleans:					
Cancer Prevention and Control Programs for State, Territorial and Tribal Organizations financed in part by Prevention and Public Health Funds	CHRISTUS Health Central Louisiana	93.752	PH-16-111-098	28,503	
Pass-through the New Mexico Department of Health:					
Hospital Preparedness Program (HPP) Ebola Preparedness and Response Activities	CHRISTUS St. Vincent Regional Medical Center	93.817	FY17EBOLA 002	828	
U.S. Department of Health and Human Services – National Bioterrorism Hospital Preparedness Program					
Pass-through the Louisiana Hospital Association:					
National Bioterrorism Hospital Preparedness Program	CHRISTUS Health Central Louisiana	93.889	72-0489377	110,640	
Pass-through the Louisiana Hospital Association:					
National Bioterrorism Hospital Preparedness Program	CHRISTUS Health Northern Louisiana	93.889	72-0489377	4,083	
Pass-through the Louisiana Hospital Association:					
National Bioterrorism Hospital Preparedness Program	CHRISTUS Health Southwest Louisiana	93.889	72-0489377	12,854	
Total National Bioterrorism Hospital Preparedness Program				<u>127,577</u>	

CHRISTUS Health

Schedule of Expenditures of Federal and State Awards (continued)

Federal Grantor/State Grantor/Pass-Through Grantor/Program or Cluster Title	Location	Federal CFDA Number/ State Contract Number	Pass-Through Entity Identifying Number	Expenditures	Amounts Passed Through to Subrecipients
FEDERAL AWARDS (continued)					
U.S. Department of Health and Human Services – National Bioterrorism Hospital Preparedness Program (continued)					
Pass-through the Texas Department of State Health Services					
Maternal and Child Health Services	CHRISTUS				
Block Grant to the States	Health				
	Santa Rosa	93.994	32-0113643	37,640	
Total U.S. Department of Health and Human Services				456,582	–
Total Expenditures of Federal Awards				\$ 1,601,908	\$ 153,372

CHRISTUS Health

Schedule of Expenditures of Federal and State Awards (continued)

Federal Grantor/State Grantor/Pass-Through Grantor/Program or Cluster Title	Location	Federal CFDA Number/ State Contract Number	Pass-Through Entity Identifying Number	Expenditures	Amounts Passed Through to Subrecipients
STATE AWARDS					
Louisiana					
Pass-Through The State of Louisiana: Facility Planning and Control	CHRISTUS Health Southwestern Louisiana	FP&C Project No. 01-107-13-03, Part B		\$ 898,835	
Total expenditures of state awards – Louisiana				898,835	
Texas					
Graduate Medical Education Program:					
Direct Awards (Texas Higher Education Coordinating Board):					
Family Practice Residency Program:					
Family Practice Residency Program Operational Grant	CHRISTUS Health Santa Rosa	THECB Contract #15682		239,729	
Family Practice Residency Program – Primary Care	CHRISTUS Health Ark-La-Tex	THECB Contract #15664		130,761	\$ 130,761
Family Practice Residency Program Operational Grant	CHRISTUS Spohn Health System	THECB Contract #15658		392,284	
Family Medicine Residents Rural Rotation	CHRISTUS Spohn Health System	THECB Various physicians		15,000	
Total Family Practice Residency Program				777,774	130,761
Graduate Medical Education Expansion Program::					
Graduate Medical Education Expansion Program – Pediatrics	CHRISTUS Health Santa Rosa	THECB Contract #14360		650,000	650,000
Graduate Medical Education Expansion Program – Family Medicine	CHRISTUS Health Santa Rosa	THECB Contract #14189		130,000	
Graduate Medical Education Expansion Program – Emergency Medicine	CHRISTUS Spohn Health System	THECB Contract #14361		130,000	
Total Graduate Medical Expansion Education Program				910,000	650,000
Total Graduate Medical Education Program				1,687,774	780,761

CHRISTUS Health

Schedule of Expenditures of Federal and State Awards (continued)

Federal Grantor/State Grantor/Pass-Through Grantor/Program or Cluster Title	Location	Federal CFDA Number/ State Contract Number	Pass-Through Entity Identifying Number	Expenditures	Amounts Passed Through to Subrecipients
STATE AWARDS (continued)					
Direct Awards (Texas Department of State Health Services)					
Texas Breast and Cervical Cancer Program	CHRISTUS Health Ark-La-Tex	Grant Contract# 2014-044921		\$ 10,922	
Total Texas Breast and Cervical Cancer Program				10,922	
Texas Medcares	CHRISTUS Health Santa Rosa	Grant Contract# 2015-047847		318,339	
Texas Medcares	CHRISTUS Health Southeast Texas	Grant Contract# 2015-047846		91,581	
Total Texas Medcares				409,920	
Direct Awards (Texas Department of Agriculture)					
Rural Health Facility Capital Improvement Program – Beeville	CHRISTUS Spohn Health System	Grant Contract# CIP-15-046		75,000	
Rural Health Facility Capital Improvement Program – Alice	CHRISTUS Spohn Health System	Grant Contract# CIP-15-047		75,000	
Rural Health Facility Capital Improvements Program – Kleberg	CHRISTUS Spohn Health System	Grant Contract# CIP-15-048		75,000	
Total Rural Health Facility Capital Improvements Program				225,000	
Total expenditures of state awards – Texas				2,333,616	780,761
Arkansas					
Direct Awards (Arkansas Department of Health):					
Arkansas Department of Health Trauma Designation Sustaining Grant	CHRISTUS Health Ark-La-Tex	4600032342-001		125,000	
Total expenditures of state awards – Arkansas				125,000	–
Total Expenditures of State Awards				\$ 3,357,451	\$ 780,761
Total Expenditures of Federal and State Awards				\$ 4,959,359	\$ 934,133

See accompanying notes to schedule of expenditures of federal and state awards.

CHRISTUS Health

Notes to Schedule of Expenditures of Federal and State Awards

June 30, 2016

1. Basis of Presentation

The accompanying schedule of expenditures of federal and state awards (the Schedule) includes the federal and state award activity of CHRISTUS Health under programs of the federal and state governments for the year ended June 30, 2016. The information in this Schedule is presented in accordance with the requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance) and the State of Texas *Uniform Grant Management Standards* (UGMS). Because the Schedule presents only a selected portion of the operations of CHRISTUS Health, it is not intended to and does not present the financial position, changes in net assets, or cash flows of CHRISTUS Health.

2. Summary of Significant Accounting Policies

Expenditures reported on the Schedule are reported on the accrual basis of accounting. Such expenditures are recognized following, as applicable, the cost principles contained in the Uniform Guidance, 45 CFR, PART 75 APPENDIX IX, *Principles for Determining Costs Applicable to Research and Development Under Grants and Contracts With Hospitals*, and the State of Texas UGMS, wherein certain types of expenditures are not allowable or are limited as to reimbursement. Therefore, some amounts presented in the Schedule may differ from amounts presented in, or used in the preparation of, the consolidated financial statements.

CHRISTUS Health has negotiated multiple indirect cost rates for consolidated entities that have been eligible to negotiate a federal indirect cost rate with the Department of Health and Human Services (DHHS). However, not all awards presented in the Schedule include indirect expenses. Allowable indirect costs for each award are determined by the related terms and conditions developed by the awarding agency for each program. CHRISTUS Health has not elected to use the 10-percent de minimis indirect cost rate allowed under Uniform Guidance.

3. Nature of Activities

CHRISTUS Health receives various grants to cover costs of specified programs. Final determination of eligibility of costs will be made by the grantors. Should any costs be found ineligible, CHRISTUS Health will be responsible for reimbursing the grantors for these amounts.

CHRISTUS Health

Notes to Schedule of Expenditures of Federal and State Awards (continued)

3. Nature of Activities (continued)

Additionally, expenditures incurred for various programs may exceed the amounts awarded from the respective pass-through entity or agency. The amounts reported on the Schedule are limited to the award amounts. Amounts in excess of this amount are paid out of non-federal and non-state sources.

Report of Independent Auditors on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Financial Statements Performed in Accordance with *Government Auditing Standards*

The Board of Directors
Ernie Sadau, Chief Executive Officer
Randolph Safady, Chief Financial Officer
CHRISTUS Health

We have audited, in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of CHRISTUS Health, which comprise the consolidated balance sheet as of June 30, 2016, and the related consolidated statements of operations and changes in net assets, and cash flows for the year then ended, and the related notes to the consolidated financial statements, and have issued our report thereon dated September 16, 2016.

Internal Control Over Financial Reporting

In planning and performing our audit of the consolidated financial statements, we considered CHRISTUS Health's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of CHRISTUS Health's internal control. Accordingly, we do not express an opinion on the effectiveness of CHRISTUS Health's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether CHRISTUS Health's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of This Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Ernst & Young LLP

September 16, 2016

Report of Independent Auditors on Compliance for Each Major Federal and State Program; Report on Internal Control Over Compliance Required by the Uniform Guidance and State of Texas Uniform Grant Management Standards

The Board of Directors
Ernie Sadau, Chief Executive Officer
Randolph Safady, Chief Financial Officer
CHRISTUS Health

Report on Compliance for Each Major Federal and State Program

We have audited CHRISTUS Health's compliance with the types of compliance requirements described in the US Office of Management and Budget (OMB) *Compliance Supplement* that could have a direct and material effect on each of CHRISTUS Health's major federal programs and the types of compliance requirements described in the State of Texas *Uniform Grant Management Standards* (UGMS) that could have a direct and material effect on each of CHRISTUS Health's major state programs for the year ended June 30, 2016. CHRISTUS Health's major federal and state programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with federal and state statutes, regulations and the terms and conditions of its federal and state awards applicable to its federal and state programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of CHRISTUS Health's major federal and state programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance), and the State of Texas UGMS. Those standards, the Uniform Guidance and the State of Texas UGMS require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could

have a direct and material effect on a major federal or state program occurred. An audit includes examining, on a test basis, evidence about CHRISTUS Health's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal and state program. However, our audit does not provide a legal determination of CHRISTUS Health's compliance.

Opinion on Each Major Federal and State Program

In our opinion, CHRISTUS Health complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal and state programs for the year ended June 30, 2016.

Report on Internal Control Over Compliance

Management of CHRISTUS Health is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered CHRISTUS Health's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal or state program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal or state program and to test and report on internal control over compliance in accordance with the Uniform Guidance and State of Texas UGMS, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of CHRISTUS Health's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal or state program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal or state program will not be prevented, or detected and corrected, on a timely basis. *A significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal or state program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance and State of Texas UGMS. Accordingly, this report is not suitable for any other purpose.

Ernst & Young LLP

September 16, 2016

CHRISTUS Health

Schedule of Findings and Questioned Costs

Year Ended June 30, 2016

Section I – Summary of Auditor’s Results

Financial Statements

Type of auditor’s report issued on whether the financial statements audited were prepared in accordance with GAAP (unmodified, qualified, adverse or disclaimer):

Unmodified

Internal control over financial reporting:

Material weakness(es) identified?

_____ yes

 x no

Significant deficiency(ies) identified?

_____ yes

 x none reported

Noncompliance material to financial statements noted?

_____ yes

 x no

Federal Awards

Internal control over major programs:

Material weakness(es) identified?

_____ yes

 x no

Significant deficiency(ies) identified?

_____ yes

 x none reported

Type of auditor’s report issued on compliance for major federal programs (unmodified, qualified, adverse or disclaimer):

Unmodified

Any audit findings disclosed that are required to be reported in accordance with 2 CFR 200.516(a)?

_____ yes

 x no

State Awards

Internal control over major programs:

Material weakness(es) identified?

_____ yes

 x no

Significant deficiency(ies) identified?

_____ yes

 x none reported

Type of auditor’s report issued on compliance for major programs (unmodified, qualified, adverse or disclaimer):

Unmodified

Any audit findings disclosed that are required to be reported in accordance with Section .510(a) of Part IV of the State of Texas Uniform Grant Management Standards?

_____ yes

 x no

CHRISTUS Health

Schedule of Findings and Questioned Costs (continued)

Section I – Summary of Auditor’s Results (continued)

Identification of major federal programs:

CFDA Number(s)	Name of Federal Program or Cluster
10.557	Special Supplemental Nutrition Program for Women, Infants, and Children
Dollar threshold used to distinguish between Type A and Type B federal programs:	<u>\$750,000</u>
Auditee qualified as low-risk auditee?	<u> x </u> yes <u> </u> no

Identification of major state programs:

CFDA Number(s)	Name of State Program or Cluster
N/A	Texas Medcares Program
N/A	Rural Health Facility Capital Improvement Program
Dollar threshold used to distinguish between Type A and Type B federal programs:	<u>\$300,000</u>
Auditee qualified as low-risk auditee?	<u> x </u> yes <u> </u> no

Section II – Financial Statement Findings

This section should identify the significant deficiencies, material weaknesses, fraud, noncompliance with provisions of laws, regulations, contracts and grant agreements, and abuse related to the consolidated financial statements for which *Government Auditing Standards* requires reporting.

No findings were noted.

CHRISTUS Health

Schedule of Findings and Questioned Costs (continued)

Section III – Federal Award Findings and Questioned Costs

This section identifies the audit findings required to be reported by the 2 CFR 200.516(a) (for example, significant deficiencies, material weaknesses, material instances of noncompliance, including questioned costs, and material abuse).

No findings were noted.

Section IV – State Award Findings and Questioned Costs

This section identifies the audit findings required to be reported by Section 510(a) of the State of Texas Uniform Grant Management Standards, Part IV (for example, significant deficiencies, material weaknesses, material instances of noncompliance, including questioned costs, and material abuse).

No findings were noted.



CHRISTUS Health

Summary Schedule of Prior Audit Findings

Year Ended June 30, 2016

The summary schedule of prior audit findings reports the status of all audit findings included in the prior audit's schedule of findings and questioned costs. The summary schedule also includes audit findings reported in the prior audit's summary schedule of prior audit findings except audit findings listed as corrected in accordance with 2 CFR 200.511(b)(1), or no longer valid or not warranting further action in accordance with paragraph 2 CFR 200.511(b)(3).

No findings were noted in 2015 or 2014.



CHRISTUS Health

Summary Schedule of Prior Audit Findings State of Louisiana

Year Ended June 30, 2016

Summary Schedule of Prior State of Louisiana Audit Findings

This section identifies prior year significant deficiencies, material weaknesses, and instances of non-compliance, including questioned costs, related state of Louisiana programs as required to be reported under Louisiana Statute.

Finding 2015-01

Criteria or specific requirement – Under Louisiana Statute, entities receiving funding from the State of Louisiana are required to submit their annual reporting package, including the audited financial statements, OMB Circular A-133 Audit report and the Data Collection Form (DCF) through the State reporting portal within six months of the entity's fiscal year-end.

Condition – CHRISTUS Health did not submit the reporting package within the six-month deadline.

Questioned costs – None.

Context – Due to a security breach the Federal Audit Clearinghouse (FAC) website was rendered unavailable for submitting information to produce the DCF and as a result the federal government extended the submission deadline to February 1, 2015. Additionally, due to significant login issues from users of the system, the FAC staff issued a statement on December 9, 2015 that they are aware of the problem and were working to resolve it. Because the system was rendered inoperable and due to the significant login issues experienced thereafter, CHRISTUS Health did not complete the DCF prior to the State of Louisiana's reporting package deadline of December 31, 2015. Once the DCF was completed, the report was submitted to the State of Louisiana.

Effect – The report was submitted late to due various technical difficulties.

Recommendation – When practical, CHRISTUS Health should submit the reporting package to the State of Louisiana in a timely manner.

Management's Corrective Action Plan – Management deems this an isolated incident due to various external circumstances and has historically and will continue to submit the reporting package in a timely manner.

Status as of June 30, 2016 - Finding is considered resolved with the acceptance of the submitted audit report by the Louisiana Legislative Auditors office.

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