

CONSOLIDATED FINANCIAL STATEMENTS AND
REPORTS ON FEDERAL AWARD PROGRAMS

Ochsner Health System and Subsidiaries
Year Ended December 31, 2016
With Reports of Independent Auditors

Ernst & Young LLP



Ochsner Health System and Subsidiaries

Consolidated Financial Statements and Reports on Federal Award Programs

Year Ended December 31, 2016

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Ernst & Young LLP
3900 One Shell Square
701 Poydras Street
New Orleans, LA 70139

Tel: +1 504 581 4200
Fax: +1 504 596 4233
ey.com

Report of Independent Auditors

The Board of Directors and Management
Ochsner Health System and Subsidiaries

We have audited the accompanying consolidated financial statements of Ochsner Health System and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 2016 and 2015, and the related consolidated statements of operations, 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 Consolidated 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 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 audit. We conducted our audit 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 audit 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

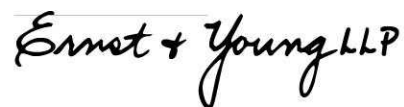
In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Ochsner Health System and its subsidiaries at December 31, 2016 and 2015, and the consolidated results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Supplementary Information – Schedule of Compensation Information

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The Schedule of Compensation Information as required under Louisiana Revised Statute 24:513A(1)(a)(3) is presented for purposes of additional analysis and is 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 additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the information is 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 April 24, 2017 on our consideration of Ochsner Health System and its subsidiaries' 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 Ochsner Health System and its subsidiaries' internal control over financial reporting and compliance.



April 24, 2017,
except for the Schedule of Compensation Information
for which the date is June 23, 2017

Ochsner Health System and Subsidiaries

Consolidated Balance Sheets

(In Thousands)

	December 31,	
	2016	2015
Assets		
Current assets:		
Cash and cash equivalents	\$ 121,569	\$ 290,803
Assets limited as to use required for current liabilities	5,600	3,858
Patient accounts receivable – net	252,598	225,527
Accounts receivable other	99,516	76,671
Inventories	56,022	50,409
Prepaid expenses and other current assets	39,731	37,634
Estimated third-party payor settlements	19,626	17,552
Total current assets	594,662	702,454
Assets limited as to use:		
By Board for capital improvements, charity, research, and other	729,436	619,703
Under bond indenture agreements	21,477	36,040
Under self-insurance trust fund	9,135	11,921
Donor-restricted long-term investments	78,433	65,533
Total assets limited as to use	838,481	733,197
Less assets limited as to use required for current liabilities	(5,600)	(3,858)
Non-current assets limited as to use	832,881	729,339
Investments in unconsolidated affiliates, real estate, and other	14,045	6,653
Property – net	821,692	754,843
Goodwill	43,558	43,077
Intangible assets	11,467	11,482
Other assets	32,534	23,950
Total assets	\$ 2,350,839	\$ 2,271,798

	December 31,	
	2016	2015
Liabilities and net assets		
Current liabilities:		
Accounts payable	\$ 150,332	\$ 140,116
Accrued salaries, wages, and benefits	149,483	148,252
Deferred revenue	9,669	12,850
Estimated third-party payor settlements	3,769	4,778
Bonds payable – current portion	7,030	6,740
Notes payable – current	52,430	52,430
Long-term debt – current portion	15,566	17,858
Other current liabilities	30,927	30,919
Total current liabilities	<u>419,206</u>	<u>413,943</u>
Pension and postretirement obligations	166,532	152,346
Bonds payable	828,408	810,166
Long-term debt	188,693	203,741
Other long-term liabilities	36,982	36,038
Total liabilities	<u>1,639,821</u>	<u>1,616,234</u>
Commitments and contingencies (<i>Notes 5 and 17</i>)		
Net assets:		
Unrestricted	596,966	565,116
Temporarily restricted	88,219	66,685
Permanently restricted	25,833	23,763
Total net assets	<u>711,018</u>	<u>655,564</u>
Total liabilities and net assets	<u><u>\$ 2,350,839</u></u>	<u><u>\$ 2,271,798</u></u>

See notes to financial statements.

Ochsner Health System and Subsidiaries

Consolidated Statements of Operations

(In Thousands)

	Year Ended December 31,	
	2016	2015
Unrestricted revenues:		
Patient service revenue – net of contractual allowances and discounts	\$ 2,285,483	\$ 2,117,008
Provision for bad debts	(88,454)	(95,738)
Net patient service revenue, less provision for bad debts	2,197,029	2,021,270
Premium revenue	286,186	289,420
Other operating revenue	322,978	277,671
Net assets released from restrictions used for operations	6,040	4,132
Total unrestricted revenues	2,812,233	2,592,493
Expenses:		
Salaries and wages	1,258,517	1,152,055
Benefits	179,299	158,432
Medical services to outside providers	132,534	142,255
Medical supplies and services	480,654	416,142
Other operating expenses	542,293	503,381
Depreciation and amortization	115,832	103,683
Interest	52,718	49,469
Total expenses	2,761,847	2,525,417
Operating income	50,386	67,076
Non-operating gains (losses):		
Investment and other realized gains – net	7,613	16,264
Loss on early extinguishment of debt	(39,110)	(12,982)
Unrealized gains (losses) on alternative investments	10,241	(4,826)
Total non-operating losses	(21,256)	(1,544)
Excess of revenues over expenses	\$ 29,130	\$ 65,532

See notes to financial statements.

Ochsner Health System and Subsidiaries

Consolidated Statements of Changes in Net Assets
(In Thousands)

	Year Ended December 31,	
	2016	2015
Unrestricted net assets		
Excess of revenues over expenses	\$ 29,130	\$ 65,532
Change in net unrealized gains (losses) on investments excluding alternative investments	28,251	(16,820)
Net assets released from restrictions used for capital acquisitions	918	1,001
Pension-related changes other than net periodic pension costs	(26,449)	(7,907)
Increase in unrestricted net assets	<u>31,850</u>	<u>41,806</u>
Temporarily restricted net assets		
Contributions	25,892	26,810
Investment income	2,601	5
Net assets released from restrictions used for:		
Operations	(6,041)	(4,132)
Capital acquisitions	(918)	(1,001)
Increase in temporarily restricted net assets	<u>21,534</u>	<u>21,682</u>
Permanently restricted net assets		
Contributions	2,070	366
Increase in permanently restricted net assets	<u>2,070</u>	<u>366</u>
Increase in net assets	55,454	63,854
Net assets – beginning of year	655,564	591,710
Net assets – end of year	<u>\$ 711,018</u>	<u>\$ 655,564</u>

See notes to financial statements.

Ochsner Health System and Subsidiaries

Consolidated Statements of Cash Flows

(In Thousands)

	Year Ended December 31,	
	2016	2015
Operating activities		
Increase in net assets	\$ 55,454	\$ 63,854
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Pension-related changes other than net periodic pension costs	26,449	7,907
Depreciation and amortization	115,832	103,683
Provision for bad debts	88,454	95,738
Non-cash portion of loss on early extinguishment of debt	3,196	3,603
Amortization of deferred financing costs and debt discounts	498	1,080
Income from equity-method investments, net of cash received	(62)	(352)
Net realized and unrealized (gains) losses on investments	(42,653)	5,363
Gain on contribution of property to joint venture	(6,994)	–
Other, net	(2,070)	(1,245)
Changes in operating assets and liabilities, net of acquisitions:		
Patient accounts receivable	(115,525)	(107,438)
Other current and non-current assets	(41,110)	(32,508)
Accounts payable	1,189	18,981
Accrued expenses and other liabilities	(17,475)	2,927
Net cash provided by operating activities	65,183	161,593
Investing activities		
Purchases of assets whose use is limited and other investments	(256,336)	(220,787)
Sales and maturities of assets whose use is limited and other investments	192,980	44,842
Capital expenditures	(166,159)	(114,444)
Other	(948)	3,016
Net cash used in investing activities	(230,463)	(287,373)
Financing activities		
Repayment of bonds payable and long-term debt	(175,183)	(140,158)
Proceeds from long-term borrowings	174,369	404,357
Payments of debt financing costs	(2,229)	(3,824)
Payments on capital lease obligations	(2,981)	(2,816)
Proceeds from contributions restricted for long-term investments	2,070	366
Net cash (used in) provided by financing activities	(3,954)	257,925
Net (decrease) increase in cash and cash equivalents	(169,234)	132,145
Cash and cash equivalents – beginning of year	290,803	158,658
Cash and cash equivalents – end of year	\$ 121,569	\$ 290,803

See notes to financial statements.

Ochsner Health System and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2016

1. Summary of Significant Accounting Policies

Organization

Ochsner Health System (OHS or Ochsner) is a not-for-profit, non-stock membership corporation and the parent company of Ochsner Clinic Foundation (OCF).

OCF, located in New Orleans, Louisiana, is a not-for-profit institution that, either directly or through its fully owned subsidiaries, owns and operates an acute care hospital known as Ochsner Medical Center (OMC), an 11-story clinic building, a 143-room hotel and related medical facilities located on a main campus in Jefferson Parish at the western end of New Orleans. OCF also owns 100% of the outstanding common stock of Ochsner System Protection Company (OSPC), a captive insurance company domiciled in Louisiana. OCF owns Ochsner Medical Center West Bank and Ochsner Baptist Medical Center, which are operated as remote campuses of OMC. It also owns and operates health centers throughout southeast Louisiana; owns a hospital in Baton Rouge that operates as Ochsner Medical Center Baton Rouge; owns a hospital in Slidell, Louisiana that operates as Ochsner Medical Center – North Shore; owns a hospital in Kenner, Louisiana that operates as Ochsner Medical Center – Kenner; operates a hospital in Raceland, Louisiana known as Ochsner St. Anne General Hospital; and owns several fitness centers that operate as Ochsner Fitness Center. OCF also provides management assistance and support for a hospital in Houma, Louisiana, known as Leonard J. Chabert Medical Center (Chabert); for a hospital in Luling, Louisiana, known as St. Charles Parish Hospital (SCPH); and for a hospital in Bay St. Louis, Mississippi known as Hancock Medical Center (Hancock). OCF also entered into an agreement with St. Bernard Parish Hospital (SBPH) in Chalmette, Louisiana in October of 2016 to provide certain administrative services and operational support on an interim basis while both parties evaluate a potential longer-term relationship.

Prior to December 31, 2016, Ochsner Community Hospitals (OCH) owned and operated Ochsner Medical Center – Kenner. It also owned Ochsner Medical Center West Bank and Ochsner Baptist Medical Center and leased these 2 facilities to OCF. OCH was merged with and into OCF effective December 31, 2016.

Basis of Presentation and Principles of Consolidation

The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (U.S. GAAP). The consolidated financial statements include the accounts of OHS and OCF and their wholly owned subsidiaries.

Ochsner Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

All intercompany accounts and transactions have been eliminated upon consolidation. The assets of any member of the consolidated group may not be available to meet the obligations of other members in the group, except as disclosed in Notes 7, 8, and 9.

Use of Estimates

The preparation of the consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents include investments with a maturity of three months or less when purchased, excluding amounts whose use is limited by board designation, under bond indenture agreements, or under self-insurance agreements.

Inventories

Inventories are stated at the lower of first-in, first-out cost or market value.

Pledges Receivable

Unconditional promises to give are recognized as revenues at their fair values in the period received. Pledges receivable are recorded net of necessary discounts and allowances. The current portion of pledges receivable is recorded in accounts receivable other and the non-current portion is recorded in other assets in the consolidated balance sheets.

Ochsner Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

Pledges receivable as of December 31 are expected to be realized as follows (in thousands):

	2016	2015
In one year or less	\$ 11,302	\$ 5,564
Between one and five years	13,217	11,309
Greater than five years	11,761	8,052
	36,280	24,925
Less discount (ranging from 0.63%–4.50% at December 31, 2016 and 2015) and allowance for uncollectible pledges	(2,478)	(2,227)
Pledges receivable – net	\$ 33,802	\$ 22,698

Investments

Investments held by OHS are included in assets limited as to use in the consolidated balance sheets. Substantially all of OHS' investments are designated as other-than-trading investments. Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the consolidated balance sheets. Investments also include investments in private equity funds, hedge funds, real estate funds, offshore fund vehicles, and funds of funds structured as limited liability corporations or partnerships or trusts. These investments are termed alternative investments in the notes to the consolidated financial statements and are accounted for under the equity method, which approximates fair value. These funds invest in certain types of financial instruments, including, among others, futures and forward contracts, options, and securities sold not yet purchased, intended to hedge against changes in the market value of investments. These financial instruments, which involve varying degrees of risk, may result in loss due to changes in the market (market risk).

Investment income or loss (including realized gains and losses on investments, interest, and dividends) is included in excess of revenues over expenses unless the income or loss is restricted by donor or law. Unrealized gains and losses on investments, other than alternative investments, are excluded from excess of revenues over expenses. If management believes a decline in the value of a particular investment is temporary, the decline is included in change in net unrealized gains (losses) excluding alternative investments on the consolidated statements of changes in net assets. If the decline is evaluated as being other than temporary, the carrying value of the

Ochsner Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

investment is written down and an impairment loss is recorded in non-operating gains and losses in the consolidated statements of operations. OHS recorded impairment losses on investment securities of approximately \$1.6 million and \$4.9 million for the years ended December 31, 2016 and 2015, respectively.

Assets Limited as to Use

Assets limited as to use primarily include assets held by trustees under indenture agreements, self-insurance trust agreements, investments restricted by donors, and designated assets set aside by the Board of Trustees (the Board) primarily for future capital improvements, over which the Board retains control and may, at its discretion, subsequently use for other purposes. Amounts required to meet current liabilities of OHS have been classified in the consolidated balance sheets as current assets.

Property – Net

Property improvements and additions are recorded at cost and capitalized and depreciated on the straight-line basis over the following estimated useful lives of the assets:

	<u>Years</u>
Land improvements	5–25
Buildings and building improvements	10–40
Leasehold improvements	12–20
Equipment, furniture, and fixtures	2–20

Impairment of Long-Lived Assets

OHS evaluates the carrying value of long-lived assets to be held and used when events and circumstances warrant such a review. The carrying value of a long-lived asset is considered impaired when the anticipated undiscounted cash flow from such asset is separately identifiable and is less than its carrying value. In that event, a loss is recognized based on the amount by which the carrying value exceeds the fair value of the long-lived asset. Fair value is determined primarily using the anticipated cash flows discounted at a rate commensurate with the risk involved. There were no impairment charges on long-lived assets recognized for the years ended December 31, 2016 or 2015.

Ochsner Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

Capitalization of Interest

OHS capitalizes interest expense on qualifying construction-in-progress expenditures based on an imputed interest rate estimating OHS' average cost of borrowed funds. Such capitalized interest becomes part of the cost of the related asset and is depreciated over its estimated useful life. Capitalized interest costs totaled approximately \$2.2 million and \$0.9 million for the years ended December 31, 2016 and 2015, respectively.

Goodwill and Intangible Assets

Goodwill and intangible assets, consisting primarily of trade name and employment contracts, were recorded mainly as a result of the merger of Alton Ochsner Medical Foundation with Ochsner Clinic LLC in 2001, which resulted in the creation of OCF. Goodwill represents the excess of the fair value of the consideration conveyed in the acquisition over the fair value of net assets acquired. Goodwill and indefinite-lived intangible assets arising from business combinations are not amortized, but rather are tested for impairment at least annually at the reporting unit level. Impairment is the condition that exists when the carrying amount of goodwill or intangible assets exceeds its implied fair value. Additional impairment assessments may be performed on an interim basis if OHS encounters events or changes in circumstances that would indicate that it is more likely than not that the carrying value of goodwill or intangible assets has been impaired. OHS has selected October 31 as its annual testing date and has determined that its reporting unit is OCF.

For purposes of the October 31, 2016, annual impairment test, OHS applied the optional provisions of Accounting Standards Update (ASU) No. 2011-08, *Intangibles – Goodwill and Other (Topic 350): Testing Goodwill for Impairment*, which provides for a qualitative impairment analysis. A qualitative impairment analysis concluded that it was more likely than not that the fair value exceeded the carrying value of the applicable reporting units. Therefore, the two-step impairment analysis was not required, and no impairment charge was recorded as of the October 31, 2016, annual impairment test.

Due to the merger of OCH into OCF, OHS performed an additional quantitative impairment assessment as of December 31, 2016. The first step in the impairment process is to estimate the fair value of the reporting unit and then compare it to the carrying value, including goodwill. If the fair value exceeds the carrying value, no further action is required and no impairment loss is

Ochsner Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

recognized. OHS determined that the use of the income and market approaches were the most appropriate methods of measuring fair value of the reporting units. These are considered Level 3 valuations in the valuation hierarchy described in Note 2.

Under the income approach, fair value is estimated using a discounted cash flow analysis. Under the market approach, fair value is estimated using a guideline company method and a comparable transaction method. Both the income approach and the market approach require significant assumptions to determine the fair value of each reporting unit. The significant assumptions used in the income approach include estimates of future revenues, profits, capital expenditures, working capital requirements, operating plans, industry data, and an appropriate discount rate for each reporting unit. The significant assumptions used in the market approach include the determination of appropriate market comparables and estimated multiples of net revenue and earnings before interest, taxes, depreciation, and amortization. OHS engaged a third-party valuation firm to assist in these fair value calculations for 2016 and 2015. OHS performed Step 1 of the impairment test using a quantitative impairment analysis as of December 31, 2016, as well as for the annual impairment test as of October 31, 2015, and concluded the fair value exceeded the carrying value, and no further action was required for 2016 or 2015.

Deferred Revenue

OHS, through OCF, engages in research activities funded by contracts from U.S. Government agencies and other private sources. Revenue related to grants and contracts is recognized as the related costs are incurred. Amounts received from grant and contract sponsors for which OCF has not yet fulfilled its obligations are included in deferred revenue in the accompanying consolidated balance sheets and recognized in future periods once the obligations have been satisfied.

Deferred revenue also includes amounts related to Medicaid supplemental payments which are yet to be recognized as revenue, as well as payments received in advance of services rendered for OCF's electronic health records (EHR) services agreements (see Note 14).

Ochsner Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

Deferred Financing Costs

In connection with the issuance of bonds and long-term debt, certain financing costs were capitalized, and are being amortized over the respective lives of the bonds and long-term debt. These costs are approximately \$11.5 million and \$11.9 million net of accumulated amortization at December 31, 2016 and 2015, respectively, and are included as a reduction to bonds payable and long-term debt in the accompanying consolidated balance sheets.

Derivative Financial Instruments

OHS utilizes interest rate swap agreements to manage its interest rate exposure. Changes in the fair value of OHS swaps not designated as hedges are recorded as non-operating gains and losses in the consolidated statements of operations. Changes in the fair value of OHS swaps that are designated as hedges are recorded as changes in unrestricted net assets in the consolidated statements of changes in net assets.

Estimated Workers' Compensation, Professional and General Liability, and Employee Health Claims

OHS is self-insured for workers' compensation, professional and general liability, and employee health claims. The provisions for estimated workers' compensation, professional liability, and employee health claims include estimates for the ultimate costs for both reported claims and claims incurred but not reported. These estimates incorporate OHS' past experience, as well as other considerations, including the nature of claims, industry data, relevant trends, and the use of actuarial information.

Accounting for Pension and Other Postretirement Plans

OHS recognizes the overfunded or underfunded status of its pension and other postretirement plans as an asset or liability in its consolidated balance sheets. Changes in the funded status of the pension and other postretirement plans are reported as a change in unrestricted net assets presented below the excess of revenues over expenses financial statement line item in the consolidated statement of changes in net assets in the year in which the changes occur.

Ochsner Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

Reinsurance

OSPC relies on reinsurance to limit its retained property insurance risk. In entering into reinsurance agreements, management considers a variety of factors, including the creditworthiness of reinsurers. In preparing its financial statements, management makes estimates of amounts receivable from reinsurers, which includes consideration of amounts, if any, estimated to be uncollectible by management based on an assessment of factors including an assessment of the creditworthiness of the reinsurers. OSPC cedes 100% of the underlying risk, and as a result, OSPC retains no insurance risk. However, OSPC is not relieved of its primary obligation and is subject to credit risk of its reinsurers. OSPC's last reinsurance contract ended on May 31, 2014. Its expiration coincided with the expiration of the last policy written by OSPC.

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by OHS has been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by OHS in perpetuity.

Consolidated Statements of Operations

For purposes of presentation, all revenues and expenses are reported as operating except for investment income, the loss from early extinguishment of debt, and other gains and losses – net, which are reported as non-operating.

Excess of Revenues Over Expenses

The consolidated statements of operations include excess of revenues over expenses, which represents OHS' performance indicator. Changes in unrestricted net assets, which are excluded from excess of revenues over expenses, consistent with industry practice, include unrealized gains and losses on other-than-trading investments, contributions used to acquire property and equipment, and pension-related changes other than net periodic pension costs.

Ochsner Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

Net Patient Service Revenue

Net patient service revenue is recognized as services are performed and is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Amounts OHS receives for treatment of patients covered by governmental programs such as Medicare and Medicaid and other third-party payors such as health maintenance organizations, preferred provider organizations, and other private insurers are generally less than OHS' established billing rates. Additionally, to provide for accounts receivable that could become uncollectible in the future, OHS establishes an allowance for doubtful accounts to reduce the carrying value of such receivables to their estimated net realizable value. Third-party accounts are pursued until all payments and adjustments are posted to the patient account. For those accounts with a patient balance after third-party liability is finalized or accounts for uninsured patients, the patient receives statements and collection letters. Patients who express an inability to pay are reviewed for potential sources of financial assistance, including OHS' charity care policy. If the patient is deemed unwilling to pay, the account is written off as bad debt and transferred to an outside collection agency for additional collection efforts.

Accordingly, the revenues and accounts receivable reported in OHS' consolidated financial statements are recorded at the net amount expected to be received. Retroactively calculated contractual adjustments arising under reimbursement agreements with third-party payors are accrued on an estimated basis in the period the related services are rendered and are adjusted as final settlements are determined.

Charity Care

OHS provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Records of charges foregone for services and supplies furnished under the charity care policy are maintained to identify and monitor the level of charity care provided. Because OHS does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. OHS estimates its costs of care provided under its charity care programs by applying a ratio of direct and indirect costs to charges to the gross foregone charges associated with providing care to charity patients. OHS' gross charity care charges include only services provided to patients who are unable to pay and qualify under

Ochsner Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

OHS' charity care policies. The ratio of cost to charges is calculated based on OHS' total expenses divided by gross patient revenue. During the years ended December 31, 2016 and 2015, the estimated costs incurred by OHS to provide care to patients who met certain criteria under its charity care policy were approximately \$42.2 million and \$54.4 million, respectively.

Community Benefit

Since December 2010, OHS and four other health care providers have formed 14 nonprofit organizations with the purpose to create a vehicle to provide services to low-income and needy patients. Expenditures recorded by OHS to fund the organizations for the years ended December 31, 2016 and 2015, were approximately \$40.7 million and \$50.8 million, respectively, and are included in other operating expenses in the consolidated statements of operations.

Provision and Allowance for Doubtful Accounts

To provide for accounts receivable that could become uncollectible in the future, OHS establishes an allowance for doubtful accounts to reduce the carrying value of such receivables to their estimated net realizable value. The primary uncertainty lies with uninsured patient receivables and deductibles, co-payments, or other amounts due from individual patients. Payment pressure from managed care/indemnity payors also affects OHS' provision for doubtful accounts.

There are various factors that can impact collection trends, such as changes in the economy, which in turn have an impact on unemployment rates and the number of uninsured and underinsured patients, the volume of patients through OHS' emergency departments, the increased burden of co-payments and deductibles to be made by patients with insurance, and business practices related to collection efforts. These factors continuously change and can have an impact on collection trends and the estimation process.

OHS has an established process to determine the adequacy of the allowance for doubtful accounts that relies on a number of analytical tools and benchmarks to arrive at a reasonable allowance. No single statistic or measurement determines the adequacy of the allowance for doubtful accounts. Some of the analytical tools that OHS utilizes include, but are not limited to, historical cash collection experience, revenue trends by payor classification, and revenue days in accounts receivable. Accounts receivable are written-off after collection efforts have been followed in accordance with OHS' policies.

Ochsner Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

Other Operating Revenue

Other operating revenue includes pharmacy revenue, rental revenue, durable medical equipment rentals and sales, gift shop revenues, EHR incentive payments, revenue from joint operating agreements and management agreements, income from equity-method investees, fitness center revenue, hotel revenue, and revenues from other miscellaneous sources.

HIT Incentive Payments and Other Benefits

Beginning in 2012, OHS, through OCF, achieved compliance with certain of the health information technology (HIT) requirements under the American Recovery and Reinvestment Act of 2009. As a result, OCF recognized approximately \$9.4 million and \$2.4 million in other operating revenue in the accompanying consolidated statements of operations for 2016 and 2015, respectively, for EHR incentives related to Medicaid and Medicare programs. These incentives partially offset the operating expenses OCF has incurred and continues to incur from its investment in HIT systems. At December 31, 2016, OCF had approximately \$0.6 million included in accounts receivable other in the accompanying consolidated balance sheets related to these incentives. No such receivables were recorded for these incentives at December 31, 2015. OHS accounts for EHR incentive payments under the grant accounting model as grants related to income.

Medicare and Medicaid EHR incentive payments are recognized as revenue after OHS has determined it is reasonably assured to comply with the meaningful use criteria over the entire applicable compliance period. OHS' compliance with the meaningful use criteria is subject to audit by the federal government.

Donor-Restricted Gifts

Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received, which is then treated as cost. 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 as net assets released from restrictions. Contributions for which restrictions are met in the same period in which the unconditional promise to give is received are recorded as unrestricted revenue.

Ochsner Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

Fair Value of Financial Instruments Other Than Investments

The following methods and assumptions were used by OHS in estimating the fair value of its financial instruments:

Current Assets and Liabilities

OHS considers the carrying amounts of financial instruments classified as current assets and liabilities to be a reasonable estimate of their fair values.

Bonds Payable

The fair values of OHS' revenue bonds are based on currently traded values of similar financial instruments as disclosed in Note 8.

Notes Payable and Long-Term Debt

OHS considers the carrying value of its notes payable and long-term debt to approximate fair value at December 31, 2016, due to the variable nature of the interest rate or based on a comparison of its fixed rates to current market rates.

Income Taxes

OHS and its subsidiaries qualify as tax-exempt organizations under Section 501(a) and are described in Section 501(c)(3) of the Internal Revenue Code and are exempt from federal and state income taxes. Management annually reviews its tax positions and has determined that there are no material uncertain tax positions that require recognition in the accompanying consolidated balance sheets. The statute of limitations remains open for tax years 2013 through 2016 in OHS' main tax jurisdictions.

Concentration of Credit Risk

OHS grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements.

Ochsner Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

Risks and Uncertainties

OHS' business could be impacted by continuing price pressure on new and renewal business, OHS' ability to effectively control health care costs, additional competitors entering OHS' markets, and federal and state legislation in the area of health care reform. Changes in these areas could adversely impact OHS' operations in the future.

In March 2010, the Patient Protection and Affordability Care Act (ACA), a comprehensive health care reform bill, was signed into law. The legislation is complex and will be phased in over several years.

OHS is unable to predict the full impact of the ACA on its future revenues and operations at this time due to the law's complexity, the limited amount of implementing regulations and interpretive guidance, uncertainty regarding the ultimate number of uninsured patients who will obtain insurance coverage, uncertainty regarding future negotiations with payors, and gradual or potentially delayed implementation. However, OHS expects that several provisions of the ACA could have a material effect on its business. Any reductions to OHS' reimbursement under the Medicare and Medicaid programs by the ACA could adversely affect its business and results of operations to the extent such reductions are not offset by increased revenues from providing care to previously uninsured individuals.

Reclassification

Certain prior year amounts have been reclassified to conform to the 2016 presentation as disclosed in Note 10. These reclassifications had no impact on total assets, liabilities, or changes in net assets.

New Accounting Pronouncements

In April 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2015-03, *Simplifying the Presentation of Debt Issuance Costs*. ASU 2015-03 requires that debt issuance costs be presented in the balance sheet as a direct deduction from the carrying amount of debt liability, consistent with debt discounts or premiums. The recognition and measurement guidance for debt issuance costs is not affected by the amendments in ASU 2015-03. The provisions of ASU 2015-03 were effective for OHS starting January 1, 2016. The

Ochsner Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

adoption of ASU 2015-03 and reclassification of debt issuance costs resulted in reductions in other assets, bonds payable, and long-term debt of approximately \$11.9 million, \$9.1 million, and \$2.8 million, respectively, as of December 31, 2015.

In August 2014, the FASB issued ASU 2014-15, *Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern*. This ASU requires management to assess a company's ability to continue as a going concern and to provide related footnote disclosures when conditions give rise to substantial doubt about a company's ability to continue as a going concern within one year from the financial issuance date. The provisions of ASU 2014-15 were effective for OHS starting January 1, 2016. The adoption of this guidance did not have an impact to OHS' consolidated financial statements.

Pending Accounting Pronouncements

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*. ASU 2014-09 provides for a single comprehensive principles-based standard for the recognition of revenue across all industries through the application of the following five-step process:

- Step 1: Identify the contract(s) with a customer.
- Step 2: Identify the performance obligations in the contract.
- Step 3: Determine the transaction price.
- Step 4: Allocate the transaction price to the performance obligations in the contract.
- Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation.

Among other provisions and in addition to expanded disclosure about the nature, amount, timing, and uncertainty of revenue, as well as certain additional quantitative and qualitative disclosures, ASU 2014-09 changes the health care industry specific presentation guidance under ASU 2011-07, *Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities*. The provisions of ASU 2014-09 are effective for OHS starting January 1, 2018, including interim periods within that reporting period. Early application is permitted only for annual periods beginning after December 15, 2016, including interim periods within that reporting period. OHS is currently evaluating the impact on its consolidated financial statements from the adoption of this guidance.

Ochsner Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

In January 2016, the FASB issued ASU 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities*. ASU 2016-01 requires that investments in equity securities, and other ownership interests in an entity that do not result in consolidation and are not accounted for under the equity method, be measured at fair value at the end of each reporting period, and the resulting changes in fair value be recognized in excess of revenues over expenses. OHS will no longer be able to recognize unrealized holding gains and losses on equity securities it classifies today as available for sale in other changes in unrestricted net assets. The provisions of ASU 2016-01 are effective for OHS starting January 1, 2018, including interim periods within that reporting period. The adoption of ASU 2016-01 will result in a reclassification of unrealized holding gains and losses on equity securities from other changes in unrestricted net assets to excess of revenues over expenses.

In February 2016, the FASB issued ASU 2016-02, *Leases*. ASU 2016-02 requires companies that lease assets to recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, in its balance sheet. The pronouncement will also require additional disclosures about the amount, timing, and uncertainty of cash flows arising from leases. The provisions of ASU 2016-02 are effective for OHS starting January 1, 2019, including interim periods within that reporting period, and early adoption is permitted. Management is currently evaluating the impact of this pronouncement on OHS' consolidated financial statements.

In August 2016, the FASB issued ASU 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. Under the new standard, the presentation of financial information for not-for-profits, specifically with respect to liquidity, financial performance, and cash flows, will be simplified and provide more relevant information to donors, grantors, creditors, and other users. This includes areas such as net asset classification, investment return, expenses, liquidity and availability of resources, and a change in the presentation of operating cash flows. The provisions of ASU 2016-14 are effective for OHS for the fiscal year starting January 1, 2018, and for interim periods starting January 1, 2019, and early adoption is permitted. Management is currently evaluating the impact of this pronouncement on OHS' consolidated financial statements.

Ochsner Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*, which is intended to reduce diversity in practice on how certain transactions are classified in the statement of cash flows. The new standard addresses eight issues: debt prepayment or debt extinguishment costs; settlement of zero-coupon debt instruments; contingent consideration payments made after a business combination; proceeds from the settlement of insurance claims; proceeds from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies; distributions received from equity method investments; beneficial interests in securitization transactions; and separately identifiable cash flows and application of the predominance principle. The provisions of ASU 2016-15 are effective for OHS starting January 1, 2018, including interim periods within that reporting period, and early adoption is permitted. Management is currently evaluating the impact of this pronouncement on OHS' consolidated financial statements.

In March 2017, the FASB issued ASU 2017-07, *Compensation—Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. The amendments in ASU 2017-07 require that an employer report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. It also requires the other components of net periodic pension cost and net periodic postretirement benefit cost to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations. The provisions of ASU 2017-07 are effective for OHS starting January 1, 2019, including interim periods within that reporting period, and early adoption is permitted. Management is currently evaluating the impact of this pronouncement on OHS' consolidated financial statements.

Ochsner Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Assets Limited as to Use and Related Fair Value Measurements and Disclosures

Accounting Standards Codification (ASC) 820, *Fair Value Measurement*, establishes a common definition for fair value to be applied to U.S. GAAP requiring use of fair value, establishes a framework for measuring fair value, and expands disclosures about such fair value measurements. ASC 820 establishes a hierarchy for ranking the quality and reliability of the information used to determine fair values. ASC 820 requires that assets and liabilities carried at fair value be classified and disclosed in one of the following three categories:

Level 1 – Unadjusted quoted market prices in active markets for identical assets or liabilities.

Level 2 – Unadjusted quoted prices in active markets for similar assets or liabilities, unadjusted quoted prices for identical or similar assets or liabilities in markets that are not active, or inputs other than quoted prices are observable for the asset or liability.

Level 3 – Unobservable inputs for the asset or liability.

OHS endeavors to utilize the best available information in measuring fair value. Financial assets and liabilities are classified based on the lowest level of input that is significant to the fair value measurement. Transfers into and transfers out of the hierarchy levels are recognized as if they had taken place at the end of the reporting period. There were no transfers between Level 1 and Level 2 in the years ended December 31, 2016 and 2015.

Assets and Liabilities Measured at Fair Value

Recurring Fair Value Measurements

The fair values of assets measured at estimated fair value on a recurring basis are estimated as described in the preceding section. These estimated fair values and their corresponding fair value hierarchy in accordance with ASC 820 are summarized as follows (in thousands):

Ochsner Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**2. Assets Limited as to Use and Related Fair Value Measurements and Disclosures
(continued)**

	December 31, 2016			
	Fair Value Measurements at Reporting Date Using			
	Quoted Prices in Active Markets for Identical Assets and Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Estimated Fair Value
Money market funds ^(a)	\$ 31,621	\$ –	\$ –	\$ 31,621
Fixed income investments ^(a)	270,900	–	–	270,900
Marketable equity securities ^(a)	166,667	–	–	166,667
Diversifiers ^(a)	69,344	–	–	69,344
Natural resources and other ^(a)	31,345	–	–	31,345
Total	\$ 569,877	\$ –	\$ –	\$ 569,877

	December 31, 2015			
	Fair Value Measurements at Reporting Date Using			
	Quoted Prices in Active Markets for Identical Assets and Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Estimated Fair Value
Money market funds ^(a)	\$ 49,100	\$ –	\$ –	\$ 49,100
Fixed income investments ^(a)	171,089	–	–	171,089
Marketable equity securities ^(a)	192,180	–	–	192,180
Diversifiers ^(a)	162,012	–	–	162,012
Natural resources and other ^(a)	22,880	–	–	22,880
Total	\$ 597,261	\$ –	\$ –	\$ 597,261

^(a) Valuation of these securities classified as Level 1 is based on unadjusted quoted prices in active markets that are readily and regularly available. Investments classified as Level 1 include mutual funds that are publicly traded.

Ochsner Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Assets Limited as to Use and Related Fair Value Measurements and Disclosures (continued)

Alternative investments and other investments of approximately \$265.7 million and \$133.0 million at December 31, 2016 and 2015, respectively, are not included in these tables since they are accounted for using the equity method of accounting and not measured at fair value. Real estate investments of approximately \$5.7 million and \$6.4 million at December 31, 2016 and 2015, respectively, are not included in these tables since they are accounted for at cost.

Investment income and other gains and losses are classified as non-operating and comprise interest and dividend income of approximately \$11.7 million and \$16.2 million (net of expenses of approximately \$1.5 million and \$1.0 million for the years ended December 31, 2016 and 2015, respectively) and realized net losses on sales of securities of approximately \$4.1 million during 2016 and realized net gains on sales of securities of approximately \$48,000 during 2015. Unrealized losses on alternative investments were approximately \$10.2 million and \$4.8 million for 2016 and 2015, respectively. Unrealized gains (losses) on investments other than alternative investments are recorded at fair value and are included in other changes in unrestricted net assets.

3. Net Patient Service Revenue

Net patient service revenue is recognized when services are provided. OHS has agreements with third-party payors that provide for payments to OHS at amounts different from its established rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered.

A summary of the significant payment arrangements with major third-party payors follows:

Medicare and Medicaid

Inpatient acute care services and defined capital costs related to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Medicare inpatient rehabilitation services are also paid at prospectively determined rates per discharge, based on a patient classification system. Psychiatric services rendered to Medicare beneficiaries are reimbursed on a prospectively determined rate per day. Outpatient services to Medicare beneficiaries are paid on a prospectively determined amount per procedure. Medicare skilled nursing care is paid on a prospectively determined amount per diem based on a patient classification system. The Medicare program's share of indirect medical education costs is reimbursed based on a stipulated formula.

Ochsner Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

3. Net Patient Service Revenue (continued)

The Medicare program's share of direct medical education costs is reimbursed based on a prospectively determined amount per resident. Inpatient services rendered to Medicaid program beneficiaries are paid at prospectively determined per diem rates. Outpatient services rendered to Medicaid program beneficiaries are reimbursed on a cost basis subject to certain limits.

OHS records retroactive Medicare and Medicaid settlements based upon estimates of amounts that are ultimately determined through annual cost reports filed with and audited by the fiscal intermediary. The difference between estimated and audited settlements is recorded as an adjustment to net patient service revenue in the year a determination is made. The favorable resolution of reimbursement issues under appeal by OHS is reported as an increase in net patient service revenue in the year the issue is resolved.

As a result of retroactive settlements of certain prior year cost reports, OHS recorded changes in estimates during the years ended December 31, 2016 and 2015. As a result of changes in prior year estimates, net patient service revenues increased approximately \$1.6 million and \$1.2 million in 2016 and 2015, respectively.

Medicaid Supplemental Payment Program

Since December 2010, Ochsner's hospitals and eight other hospitals (Baton Rouge General Medical Center, CHRISTUS Schumpert Health System, CHRISTUS St. Frances Cabrini Hospital, CHRISTUS St. Patrick Hospital, Lakeview Regional Medical Center, The Regional Medical Center of Acadiana, Rapides Regional Medical Center, and Tulane University Hospital and Clinic) entered into collaborations with the State and several units of local government in Louisiana (Jefferson Parish Hospital Service District No. 1, Jefferson Parish Hospital Service District No. 2, Natchitoches Hospital District No. 1, Jefferson Parish Human Services Authority, Terrebonne Parish Hospital Service District #1, Southern Regional Medical Corporation, Hospital Service District No. 3 of the Parish of Allen, The Parish Hospital Service District for the Parish of Orleans – District A, Savoy Medical Center, Hospital Service District No. 1 of Iberia Parish, St. Tammany Parish Hospital Service District No. 1, St. Tammany Parish Hospital Service District No. 2, and Vermilion Parish Hospital Service District #2) to more fully fund the Medicaid program (the Program) to ensure services remain available to low-income and needy patients in the respective communities.

Ochsner Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

3. Net Patient Service Revenue (continued)

These collaborations enable the governmental entities to increase support for the Uncompensated Care Cost (UCC) program for hospital services to the Medicaid and uninsured populations, the Medicaid Upper Payment Limits (UPL) programs for hospital and physician services to the

Medicaid fee-for-service population, and the Full Medicaid Payment (FMP) program for physician services to the Medicaid managed care population. Each State's UCC and UPL methodology must comply with its State plan and be approved by the Centers for Medicare & Medicaid Services (CMS). Under the UCC and UPL programs, federal matching funds are not available for Medicaid payments that exceed a provider's individual UPL or UCC entitlement.

Under the FMP program, Medicaid Managed Care Organizations contracted to pay increased reimbursement for physician services that more closely aligns the reimbursement rates for the Medicaid managed care population with the equivalent total reimbursement rates for the Medicaid fee-for-service population.

In 2016 and 2015, OHS recognized approximately \$195.6 million and \$164.6 million, respectively, in net patient service revenue related to the Program and recorded accounts receivable of approximately \$15.1 million at December 31, 2016, and deferred revenue of approximately \$4.1 million at December 31 2015. Such amounts are included in accounts receivable other and deferred revenue, respectively, in the accompanying consolidated balance sheets.

Humana Inc.

OHS entered into a provider contract with Humana Inc. to provide services for its commercial and senior members on a fee-for-service basis for physician services and at prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates for hospital services. Also, OHS provided services to approximately 35,000 senior members under a capitation contract for both physician and hospital services. Premium revenue from Humana Inc. under the capitation contract approximated \$286.2 million and \$289.4 million in 2016 and 2015, respectively, and is included in premium revenue in the accompanying consolidated statements of operations. Expenses for medical services to outside providers under the capitation contract approximated \$132.5 million and \$142.3 million in 2016 and 2015, respectively, and are included in medical services to outside providers in the

Ochsner Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

3. Net Patient Service Revenue (continued)

accompanying consolidated statements of operations. Net revenue from Humana Inc. on a fee-for-service basis approximated \$173.1 million and \$181.6 million in 2016 and 2015, respectively, and is included in net patient service revenue in the accompanying consolidated statements of operations.

Managed Care

OHS has also entered into contractual arrangements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. Inpatient and outpatient services rendered to managed care subscribers are reimbursed at prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

OHS recognizes net patient service revenue associated with services provided to patients who have third-party payor coverage on the basis of contractual rates for the services rendered. For uninsured patients who are not eligible for charity care, OHS recognizes revenue on the basis of its standard rates for services provided (or on the basis of discounted rates, if negotiated or provided by policy). Based on historical experience, a significant portion of OHS' uninsured and underinsured patients will be incapable or reluctant to pay for the services provided. Therefore, OHS records a significant provision for bad debts in the period the services are provided related to patient receivables and deductibles, co-payments, or other amounts due from individual patients who have been deemed unwilling to pay.

The table below shows the sources of patient service revenue (net of contractual allowances and discounts), before the provision for bad debts, for the years ended December 31 (in thousands).

	<u>2016</u>	<u>2015</u>
Government agencies	\$ 797,771	\$ 722,364
Patients	29,405	49,501
Managed care/indemnity	1,458,307	1,345,143
Patient service revenue, net of contractual allowances and discounts	<u>\$ 2,285,483</u>	<u>\$ 2,117,008</u>

Ochsner Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

4. Patient Accounts Receivable

At December 31, OHS' patient accounts receivable balances were due from the following sources (in thousands):

	<u>2016</u>	<u>2015</u>
Managed care/indemnity	\$ 186,105	\$ 145,830
Government agencies	87,735	93,073
Patients	25,330	39,538
Total	<u>299,170</u>	<u>278,441</u>
Less allowance for doubtful accounts	<u>(46,572)</u>	<u>(52,914)</u>
Patient accounts receivable – net	<u>\$ 252,598</u>	<u>\$ 225,527</u>

The allowance for doubtful accounts due from patients was 4.5% and 5.6% of the accounts receivable balance at December 31, 2016 and 2015, respectively. The allowance for doubtful accounts due from managed care/indemnity payors was 10.4% and 9.0% of the accounts receivable balance at December 31, 2016 and 2015, respectively.

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

	<u>Balance at Beginning of Year</u>	<u>Provision for Doubtful Accounts</u>	<u>Accounts Written Off, Net of Recoveries</u>	<u>Balance at End of Year</u>
Year Ended December 31, 2015	\$ 51,589	\$ 95,738	\$ (94,413)	\$ 52,914
Year Ended December 31, 2016	52,914	88,454	(94,796)	46,572

Ochsner Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

5. Property – Net

OHS' investment in property at December 31 is as follows (in thousands):

	2016	2015
Land and improvements	\$ 97,599	\$ 94,552
Buildings and leasehold improvements	694,184	669,388
Equipment, furniture, and fixtures	1,058,700	1,083,683
Building and building improvements held for lease	51,396	45,875
Construction-in-progress	99,906	36,845
Total property – at cost	2,001,785	1,930,343
Less accumulated depreciation	1,180,093	1,175,500
Property – net	\$ 821,692	\$ 754,843

Depreciation and amortization expense totaled approximately \$115.8 million and \$103.7 million for the years ended December 31, 2016 and 2015, respectively.

At December 31, 2016 and 2015, OHS has purchase commitments totaling approximately \$87.0 million and \$29.7 million, respectively, toward additional capital expenditures.

OHS leases certain software and equipment under capital leases. Capital lease assets are included in equipment, furniture, and fixtures in the accompanying consolidated balance sheets as of December 31 and are as follows (in thousands):

	2016	2015
Software and equipment	\$ 23,668	\$ 16,679
Accumulated amortization	(7,675)	(5,173)
Net carrying value of capital lease assets	\$ 15,993	\$ 11,506

Amortization expense applicable to the capital lease asset is included in depreciation and amortization in the accompanying consolidated statements of operations.

Ochsner Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

6. Goodwill and Indefinite-Lived Intangible Assets

On August 31, 2001, Alton Ochsner Medical Foundation and Ochsner Clinic LLC effected a merger transaction resulting in the creation of OCF and the net assets of Ochsner Clinic LLC being acquired by Alton Ochsner Medical Foundation.

The cost to acquire Ochsner Clinic LLC was allocated to the assets acquired and liabilities assumed according to their estimated fair values. In addition, the carrying values of certain other assets and liabilities of Ochsner Clinic LLC were changed to reflect management's estimate of fair value under purchase accounting.

On May 2, 2016, OCF acquired 100% of the equity interest in Sculpting Center of New Orleans, LLC. As part of this transaction, OCF recorded \$0.5 million of goodwill related to the acquisition.

Amounts recorded as goodwill and indefinite-lived intangible assets as of December 31 are as follows (in thousands):

	<u>2016</u>	<u>2015</u>
Goodwill	\$ 43,558	\$ 43,077
Trade name – intangible assets	\$ 11,433	\$ 11,433
Other – intangible assets	34	49
	<u>\$ 11,467</u>	<u>\$ 11,482</u>

7. Notes Payable

OCF has a loan agreement with a bank that provides a credit line with maximum borrowings of \$53.0 million. The line of credit currently expires on June 12, 2017. Borrowings under the arrangement are unsecured; however, OCF must meet certain financial covenants. Management believes OCF was in compliance with these covenants at December 31, 2016 and 2015. At December 31, 2016 and 2015, OCF had borrowings outstanding under this arrangement of approximately \$52.4 million. The interest rate on outstanding borrowings is based on the London Interbank Offered Rate (LIBOR) and, consequently, fluctuates from month to month. The rate on outstanding indebtedness under this arrangement was 2.12% and 1.74% at December 31, 2016 and 2015, respectively. All amounts are classified as current at December 31, 2016 and 2015.

Ochsner Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

8. Bonds Payable

At December 31, bonds payable consisted of the following tax-exempt and taxable bonds (in thousands). The tax-exempt revenue bonds were issued by the Louisiana Public Facilities Authority (LPFA) on behalf of OCF. The taxable bonds were issued by OCF.

	2016	2015
Series 2007-A tax-exempt bonds issued by the LPFA September 2007, due serially 2009–2047, annual interest rates ranging from 5.00% to 5.50%	\$ 250,805	\$ 255,345
Series 2007-B tax-exempt bonds issued by the LPFA September 2007, due serially 2009–2047 annual interest rates ranging from 5.00% to 5.50%	53,445	53,660
Series 2011 tax-exempt bonds issued by the LPFA May 2011, due serially 2017–2023, then on term in 2031, 2037, and 2041, at annual interest rates ranging from 4.00% to 6.75%	–	150,000
Series 2015 taxable bonds issued June 2015, due in 2045, annual interest rate at 5.90%	252,820	252,820
Series 2015 tax-exempt bonds issued by the LPFA August 2015, due serially 2016–2035, then on term in 2040 and 2047, annual interest rates ranging from 2.00% to 5.00%	112,815	114,800
Series 2016 tax-exempt bonds issued by the LPFA May 2016, due serially 2023-2036, then on term in 2041 and 2047, annual interest rates ranging from 3.00% to 5.00%	155,660	–
Unamortized net bond premium (discount)	18,768	(638)
Total	844,313	825,987
Less deferred financing costs	8,875	9,081
Less current portion	7,030	6,740
Non-current portion of bonds payable	\$ 828,408	\$ 810,166

The Series 2007-A, Series 2011, Series 2015 taxable, and Series 2015 tax-exempt bonds are general obligations of OCF. Effective on December 31, 2016, the 2007-B bonds also became general obligations of OCF. The security includes a pledge of all present and future accounts receivable of OCF and a mortgage of certain property.

Ochsner Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

8. Bonds Payable (continued)

Also, under the terms of the bond indenture, OCF and OCH are required to make certain deposits of principal and interest with a trustee. Such deposits are included with assets limited as to use in the consolidated financial statements. The bond indenture also places limits on the incurrence of additional borrowings by OCF and requires that OCF satisfy certain measures of financial performance as long as the bonds are outstanding. Management is not aware of any noncompliance with these requirements.

In June 2015, OCF issued taxable bonds in the amount of \$252.8 million and in August 2015, the Louisiana Public Facilities Authority issued tax-exempt revenue bonds in the amount of \$114.8 million under a loan agreement with OCF. OCF used a portion of the proceeds to pay the cost of partially refunding the Series 2007-A and 2007-B bonds in the amounts of approximately \$96.9 million and \$20.3 million, respectively, resulting in a loss on extinguishment of approximately \$13.0 million.

In May 2016, the Louisiana Public Facilities Authority issued tax-exempt revenue bonds in the amount of \$155.7 million under a loan agreement with OCF. OCF used the proceeds to pay the cost of refunding the Series 2011 bonds in the amount of \$150.0 million resulting in a loss on extinguishment of approximately \$39.1 million.

At December 31, 2016, scheduled repayments of principal and sinking fund installments to retire the bonds payable for the next five fiscal years are as follows (in thousands):

Years ending December 31:	
2017	\$ 7,030
2018	7,345
2019	7,695
2020	8,065
2021	8,465

The estimated fair value of the Series 2007-A tax-exempt bonds, Series 2007-B tax-exempt bonds, Series 2011 tax-exempt bonds, 2015 tax-exempt bonds, 2015 taxable bonds, and Series 2016 tax-exempt bonds as of December 31, 2016 and 2015, is approximately \$875.9 million and \$887.9 million, respectively. This fair value is based on quoted market prices for similarly rated health care revenue bond issues, a Level 2 input.

Ochsner Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

9. Long-Term Debt

A summary of long-term debt at December 31 is as follows (in thousands):

	2016		2015
Working capital note, due May 2026 (subject to six additional 5-year extensions), including accrued interest at rates varying from .88% to 1.85% during 2016 with a rate of 1.85% as of December 31, 2016	\$ 8,604	\$	8,508
Note payable 4.61% Senior Secured Note, entered into March 2013, due March 2033	6,127		6,375
Note payable 5.26% Senior Secured Note, entered into December 2013, due December 2028	54,028		57,177
Promissory note entered into December 2013, due December 2020 with interest synthetically fixed at 3.97%	14,698		16,773
Note payable 5.09% Senior Secured Note, entered into July 2014, due August 2034	74,286		76,818
Promissory note entered into October 2014, due October 2021 with interest at 3.75%	19,067		20,533
Promissory note entered into September 2015, due September 2022 with interest synthetically fixed at 4.13%	27,000		30,000
Software and equipment loans, due varying dates in 2016–2019	3,131		8,664
Total long-term debt	206,941		224,848
Less deferred financing costs	2,658		2,847
Less unamortized discount	24		402
Less current portion	15,566		17,858
Non-current portion of long-term debt	\$ 188,693	\$	203,741

Ochsner Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

9. Long-Term Debt (continued)

St. Anne

On May 1, 2006, OCF entered into lease and management services agreements with Lafourche Parish Hospital Service District No. 2 (Lafourche), which owns and operates St. Anne General Hospital and related facilities (St. Anne) of Raceland, Louisiana. Under the agreements, OCF leases the St. Anne buildings and facilities, purchased working capital and certain equipment of St. Anne, and operates the hospital for a specified period of time. As part of the agreement, OCF entered into an unsecured note payable with Lafourche for the purchase of its working capital and equipment for \$7.1 million. On December 31, 2010, OCF and Lafourche executed an amendment in which the principal and all accrued and unpaid interest of approximately \$8.0 million became the new principal amount of the note and the note was extended for five years to a maturity date of May 1, 2016. On June 1, 2015, OCF and Lafourche executed an amendment in which the aggregate principal and accrued interest amount of approximately \$8.4 million was extended to 2026 with six 5-year renewal options, to concur with the lease agreement. The interest rate on the working capital note, based on the 5-Year Yield Tax Exempt Insured Revenue Bond Rate published by Bloomberg, was 1.85% and 1.31% at December 31, 2016 and 2015, respectively. All amounts are classified as non-current at December 31, 2016 and 2015, and are included in long-term debt on the consolidated balance sheets.

March 2013 Note Payable

Pursuant to OCF's purchase of two Medical Office Buildings on November 15, 2012, OCF entered into a loan in the principal amount of \$7.0 million on March 12, 2013. The loan is secured by first mortgage liens on medical office building properties at 1850 East Gause Boulevard (North Shore Medical Office Building 1) and 105 Medical Center Drive (North Shore Medical Office Building 2), both in Slidell, Louisiana, and both in close proximity to Ochsner Medical Center – North Shore. The loan is in the form of a Senior Secured Note bearing interest at the fixed annual rate of 4.61%. Principal and interest payments are due monthly based upon a 20-year (240-month) amortization period and actual/360-day interest period.

Ochsner Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

9. Long-Term Debt (continued)

December 2013 Note Payable

OCF entered into a loan in the principal amount of \$63.0 million on December 30, 2013. The loan is secured by first mortgage liens on OCF facilities at 2005 Veterans Memorial Boulevard, Metairie, Louisiana, and 1950 Gause Boulevard, Slidell, Louisiana. The loan is in the form of a Senior Secured Note bearing interest at the fixed annual rate of 5.26%. Principal and interest payments are due monthly based upon a 15-year (180-month) amortization period and actual/360-day interest period.

December 2013 Promissory Note

OCF entered into a loan with a financial institution (the 2013 Loan) in the principal amount of \$20.8 million on December 31, 2013. The 2013 Loan is in the form of a promissory note bearing stated interest of 30-day LIBOR plus 2.00%. The security includes a pledge of all present and future accounts receivable of OCF and a mortgage of certain property. Principal and interest payments are due monthly based upon a 15-year (180-month) fixed principal payment amortization period with the balance of the outstanding principal due on a 7-year maturity date of December 30, 2020, and actual/360-day interest period. As part of a program to manage interest rate risk, OHS entered into an interest rate swap agreement on December 19, 2013, effective as of December 30, 2013. OCF pays a 1.97% fixed interest rate on the outstanding notional amount based on the outstanding principal balance of the 2013 Loan to the counterparty and receives the floating amount of 30-day LIBOR as of the date of rate-set. The effect of the swap agreement is to fix OCF's interest rate on the 2013 Loan at 3.97%. At December 31, 2016 and 2015, the fair value of the interest rate swap agreement was a liability of \$171,000 and \$320,000, respectively, and is included in other long-term liabilities in the consolidated balance sheets.

July 2014 Note Payable

OCF entered into a loan in the principal amount of \$80.0 million on July 31, 2014. The loan is secured by first mortgage liens on OCF facilities at 17000 Medical Center Drive, Baton Rouge, Louisiana, and 16777 Medical Center Drive, Baton Rouge, Louisiana. The loan is in the form of a Senior Secured Note bearing interest at the fixed annual rate of 5.09%. Principal and interest payments are due monthly based upon a 20-year (240-month) amortization period and actual/360-day interest period.

Ochsner Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

9. Long-Term Debt (continued)

October 2014 Promissory Note

OCF entered into a loan with a financial institution (the 2014 Loan) in the principal amount of \$22.0 million on October 30, 2014. The 2014 Loan is in the form of a promissory note bearing stated interest of 3.75%. The security includes a pledge of all present and future accounts receivable of OCF and a mortgage of certain property. Principal and interest payments are due quarterly with the first payment due on February 1, 2015, and based upon a 15-year fixed principal payment amortization period. The balance of the outstanding principal is due on a 7-year maturity date of October 31, 2021, and actual/360-day interest period.

September 2015 Promissory Note

OCF entered into a loan with a financial institution (the 2015 Loan) in the principal amount of \$30.0 million on September 30, 2015. The 2015 Loan is in the form of a promissory note bearing stated interest of 3-month LIBOR plus 2.25%. The security includes a pledge of all present and future accounts receivable of OCF and a mortgage of certain property. Principal and interest payments are due quarterly beginning January 1, 2016, based upon a 10-year fixed quarterly principal payment amortization period, with the balance of the outstanding principal due on a 7-year maturity date of September 30, 2022, and actual/360-day interest period. As part of a program to manage interest rate risk, OHS entered into an interest rate swap agreement on September 1, 2015, effective as of September 30, 2015. OCF pays a 1.88% fixed interest rate on the outstanding notional amount based on the outstanding principal balance of the 2015 Loan to the counterparty and receives the floating amount of 3-month LIBOR as of the date of rate-set. The effect of the swap agreement is to fix OCF's interest rate on the 2015 Loan at 4.13%. At December 31, 2016, the fair value of the interest rate swap agreement was an asset of \$7,000 and is included within other assets in the consolidated balance sheet. At December 31, 2015, the fair value of the interest rate swap agreement was a liability of \$190,000 and is included in other long-term liabilities in the consolidated balance sheets.

Ochsner Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

9. Long-Term Debt (continued)

At December 31, 2016, scheduled repayments of long-term debt for the next five fiscal years are as follows (in thousands):

Years ending December 31:	
2017	\$ 15,566
2018	13,291
2019	13,616
2020	20,224
2021	23,870

10. Employee Benefit Plans

Defined Benefit Pension Plan

Certain employees of OCF and its subsidiaries are covered under a defined benefit pension plan (the Defined Benefit Plan). The Defined Benefit Plan is non-contributory and provides benefits that are based on the participants' credited service and average compensation during the last five years of covered employment. As of December 31, 2006, benefit accruals ceased for all plan participants under age 40 and those over age 40 who elected to freeze their retirement plan benefits. OCF made an additional change to the Defined Benefit Plan, and as of December 31, 2009, benefit accruals ceased for all plan participants under age 55 with less than 10 years of service (rounded to the nearest 6 months). Physician/executive participants are frozen as of December 31, 2009, regardless of age and service. Participants who are not frozen as of December 31, 2009, can accrue benefits until the earlier of age 65 or December 31, 2015. No new participants are allowed to enter the Defined Benefit Plan. OCF makes contributions to its qualified plan that satisfy the minimum funding requirements under the Employee Retirement Income Security Act of 1974. These contributions are intended to provide not only for benefits attributed to services rendered to date but also those expected to be earned in the future.

Ochsner Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

10. Employee Benefit Plans (continued)

The following table sets forth the changes in benefit obligations, changes in plan assets, and components of net periodic benefit cost (in thousands):

	December 31,	
	2016	2015
	<hr/>	
Change in benefit obligation:		
Benefit obligation – beginning of year	\$ 542,801	\$ 561,526
Service cost	–	–
Interest cost	23,619	22,378
Actuarial loss (gain)	22,379	(18,678)
Benefits paid	(34,984)	(22,425)
Benefit obligation – end of year	<hr/> 553,815	<hr/> 542,801
Change in plan assets:		
Fair value of plan assets – beginning of year	406,618	420,066
Actual return on plan assets	22,165	372
Employer contributions	10,610	8,605
Benefits paid	(34,984)	(22,425)
Fair value of plan assets – end of year	<hr/> 404,409	<hr/> 406,618
Funded status	<hr/> <hr/> \$ (149,406)	<hr/> <hr/> \$ (136,183)

Ochsner Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

10. Employee Benefit Plans (continued)

	December 31,	
	2016	2015
Amounts recognized in the consolidated balance sheets consist of:		
Pension and postretirement obligations – current portion	\$ –	\$ –
Pension and postretirement obligations – non-current portion	(149,406)	(136,183)
Unrestricted net assets	N/A	N/A
Amounts recognized in unrestricted net assets:		
Net actuarial loss	253,845	228,062
Prior service credit	–	–
Total amounts recognized	<u>253,845</u>	<u>228,062</u>
Other changes in plan assets and benefit obligations recognized in unrestricted net assets:		
Net loss	32,623	14,469
Recognized loss	(6,840)	(5,857)
Recognized prior service credit	–	–
Total amounts recognized	<u>\$ 25,783</u>	<u>\$ 8,612</u>

Weighted average assumptions used to determine projected benefit obligations at December 31 were as follows:

	2016	2015
Weighted average discount rate	4.15%	4.35%
Rate of compensation increase	N/A	N/A

Ochsner Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

10. Employee Benefit Plans (continued)

Net periodic pension cost for the years ended December 31 includes the following components (in thousands):

	<u>2016</u>	<u>2015</u>
Service cost	\$ —	\$ —
Interest cost	23,619	22,378
Expected return on plan assets	(32,409)	(33,519)
Amortization of net loss	6,840	5,857
Recognized prior service credit	—	—
Net periodic pension benefit	<u>\$ (1,950)</u>	<u>\$ (5,284)</u>

Weighted average assumptions used to determine net periodic pension cost for the years ended December 31 were as follows:

	<u>2016</u>	<u>2015</u>
Weighted-average discount rate	4.35%	4.06%
Expected return on plan assets	7.70%	8.10%
Rate of compensation increase	N/A	N/A

Ochsner Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

10. Employee Benefit Plans (continued)

The fair values of the Defined Benefit Plan assets at December 31 are as follows (in thousands):

	2016			
	Fair Value Measurements at Reporting Date Using			
	Quoted Prices in Active Markets for Observable Identical Assets and Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Estimated Fair Value
Money market funds ^(a)	\$ 28,126	\$ –	\$ –	\$ 28,126
Fixed income investments ^{(a)(b)(c)}	16,994	48,662	–	65,656
Marketable equity securities ^{(a)(b)(c)}	71,874	42,869	46,541	161,284
Absolute return ^{(b)(c)}	10,807	10,647	79,996	101,450
Private equity/venture capital ^(c)	–	–	14,770	14,770
Natural resources ^{(a)(c)}	27,731	–	5,392	33,123
Total	\$ 155,532	\$ 102,178	\$ 146,699	\$ 404,409

	2015			
	Fair Value Measurements at Reporting Date Using			
	Quoted Prices in Active Markets for Observable Identical Assets and Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Estimated Fair Value
Money market funds ^(a)	\$ 8,499	\$ –	\$ –	\$ 8,499
Fixed income investments ^{(a)(b)(c)}	15,292	46,135	–	61,427
Marketable equity securities ^{(a)(b)(c)}	77,168	37,567	42,503	157,238
Absolute return ^{(b)(c)}	10,847	–	121,636	132,483
Private equity/venture capital ^(c)	–	–	17,299	17,299
Natural resources ^{(a)(c)}	23,939	–	5,733	29,672
Total	\$ 135,745	\$ 83,702	\$ 187,171	\$ 406,618

^(a) Valuation of these securities classified as Level 1 is based on unadjusted quoted prices in active markets that are readily and regularly available.

Ochsner Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

10. Employee Benefit Plans (continued)

- ^(b) Represents funds invested in common/collective trust funds or other alternative investments. Investments classified as Level 1 represent a fund that is publicly traded. Valuation of this fund is based on unadjusted quoted prices in active markets that are readily and regularly available. Level 2 classification represents investments in common/collective trust funds or other alternative investment funds. The estimated fair value is based upon the reported Net Asset Value (NAV) provided by fund managers, and this value represents the amount at which transfers into and out of the fund are affected. This fund provides reasonable levels of price transparency and can be corroborated through observable market data.
- ^(c) In general, investments classified within Level 3 are alternative investments and use many of the same valuation techniques and inputs as described above, including reported NAV. However, if key inputs are unobservable, or if the investments are less liquid and there is very limited trading activity, the investments are generally classified as Level 3. The use of independent non-binding broker quotations to value investments generally indicates there is a lack of liquidity or the general lack of transparency in the process to develop the valuation estimates generally causing these investments to be classified in Level 3. This category includes funds that are invested in hedge fund and private equity investments that provide little or no price transparency due to the infrequency with which the underlying assets trade and generally require additional time to liquidate in an orderly manner. Accordingly, the values of these alternative asset classes are based on inputs that cannot be readily derived from or corroborated by observable market data and are based on investment balances provided by fund managers and adjusted for contributions and distributions in the event such balances pertain to an interim date. The 2015 amounts reflected above include the reclassification of \$19 million of investments from Level 3 to Level 2.

A rollforward of the fair value measurements for all assets measured at estimated fair value on a recurring basis using significant unobservable (Level 3) inputs for the year ended December 31, 2016, is as follows (in thousands):

	January 1, 2016	Gains (Losses)	Purchases	Sales	December 31, 2016
Fixed income	\$ -	\$ -	\$ -	\$ -	\$ -
Equity securities	42,503	4,038	-	-	46,541
Absolute return	121,636	1,094	10,000	(52,734)	79,996
Private equity/venture capital	17,299	2,306	85	(4,920)	14,770
Natural resources	5,733	314	-	(655)	5,392
Total	\$ 187,171	\$ 7,752	\$ 10,085	\$ (58,309)	146,699

Ochsner Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

10. Employee Benefit Plans (continued)

The Defined Benefit Plan asset allocation as of the measurement dates (December 31, 2016 and 2015) and the target asset allocation, presented as a percentage of total plan assets, were as follows:

	2016	2016 Target Allocation	2015
Debt securities	16%	15%	15%
Equity securities	40	40	39
Private equity/venture capital	4	2	4
Hedge funds	25	33	33
Natural resources/REITs	8	10	7
Other	7	–	2

Asset allocations and investment performance are formally reviewed at regularly scheduled meetings several times during the year by the Investment Committee of OCF. OCF utilizes an investment consultant and multiple managers for different asset classes. The Investment Committee takes into account liquidity needs of the plan to pay benefits in the short term and the anticipated long-term obligations of the Defined Benefit Plan.

The primary financial objectives of the Defined Benefit Plan are to (1) provide a stream of relatively predictable, stable, and constant earnings in support of the Defined Benefit Plan's annual benefit obligations and (2) preserve and enhance the real (inflation-adjusted) value of the assets of the Defined Benefit Plan. The long-term investment objectives of the Defined Benefit Plan are to (1) attain the average annual total return assumed in the Defined Benefit Plan's most recent actuarial assumptions (net of investment management fees) over rolling five-year periods, (2) outperform the Defined Benefit Plan's custom benchmark, and (3) outperform the median return of a pool of retirement funds to be identified in conjunction with OCF's investment consultant.

The asset allocation is designed to provide a diversified mix of asset classes, including U.S. and foreign equity securities, fixed income securities, real estate investment trusts (REITs), natural resources, cash, and funds to hedge against deflation and inflation. Risk management practices include various criteria for each asset class, including measurement against several benchmarks, achievement of a positive risk-adjusted return, and investment guidelines for each class of assets that enumerate types of investment allowed in each category.

Ochsner Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

10. Employee Benefit Plans (continued)

The OCF Retirement Plan Statement of Investment Policies and Objectives provides for a range of minimum and maximum investments in each asset class to allow flexibility in achieving the expected long-term rate of return. Historical return patterns and correlations, consensus return forecast, and other relevant financial factors are analyzed to check for reasonableness and appropriateness of the asset allocation to ensure that the probability of meeting actuarial assumptions is reasonable. OCF Treasury staff oversees the day-to-day activities involving assets of the Defined Benefit Plan and the implementation of any changes adopted by the Investment Committee.

OCF currently expects to make a contribution to the Defined Benefit Plan of approximately \$15.1 million in 2017.

For 2016 and 2015, OCF's Defined Benefit Plan had accumulated benefit obligations of approximately \$553.8 million and \$542.8 million, respectively.

The estimated net loss for the Defined Benefit Plan that will be amortized from accumulated unrestricted net assets into net periodic benefit cost over the next fiscal year is approximately \$7.5 million.

Future benefit payments expected to be paid in each of the next five fiscal years and in the aggregate for the following five years as of December 31, 2016, are as follows (in thousands):

Years ending December 31:	
2017	\$ 26,356
2018	28,035
2019	29,479
2020	30,842
2021	32,153
2022–2026	175,200
	<u>\$ 322,065</u>

Ochsner Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

10. Employee Benefit Plans (continued)

Defined Contribution Plans

All employees of OCF meeting eligibility requirements may participate in the Ochsner Clinic Foundation 401(k) Plan (the Plan). OCF may annually elect to make a retirement contribution on behalf of eligible employees in an amount up to 2% of the participant's annual eligible compensation. In addition, OCF may annually elect to make a match for eligible employees of 50% of the first 4% the employees contribute into the Plan. At December 31, 2016 and 2015, OHS has accrued approximately \$28.1 million and \$24.6 million, respectively, for matching contributions to the Plan for the 2016 and 2015 fiscal years, respectively.

Certain OCF employees are also covered under a 457(f) plan. The 457(f) plan was created to replace 100% of the benefit target for employees under age 65 as of December 31, 2009, whose benefits in the Defined Benefit Plan were frozen. The participant pays taxes at vesting and payout occurs at the later of age 65 or retirement. Participants of the 457(f) plan also participate in the 401(k) contributions. OHS' accompanying consolidated balance sheets reflect a liability of approximately \$13.6 million and \$12.6 million for the 457(f) plan at December 31, 2016 and 2015, respectively.

Other Postretirement Benefits

OCF also provides certain health care and life insurance benefits for retired employees. OCF funds these benefits on a pay-as-you-go basis. The obligations under the postretirement plan are approximately \$2.0 million and \$1.9 million at December 31, 2016 and 2015, respectively.

11. Endowment Funds and Temporarily and Permanently Restricted Net Assets

OHS has 776 temporarily restricted funds and 66 permanently restricted funds established for a variety of purposes. These funds are classified and reported based on the existence or absence of donor-imposed restrictions. Restricted net assets include funds dedicated to Medical Education, Nursing Education, Pastoral Care, Biomedical Research, Cancer Research, Cardiology Research, Transplant Research and Alzheimer's Research.

Ochsner Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

11. Endowment Funds and Temporarily and Permanently Restricted Net Assets (continued)

ASC 958-205, *Not-for-Profit Entities – Presentation of Financial Statements*, provides guidance on the net asset classification of donor-restricted endowment funds for a not-for-profit organization that is subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA), which the state of Louisiana enacted on July 1, 2010.

UPMIFA requires OHS to classify the portion of each donor-restricted endowment fund that is not classified as permanently restricted net assets as temporarily restricted net assets (time restricted) until appropriated for expenditure. Temporarily restricted net assets available for appropriations at December 31, 2016 and 2015, total approximately \$6.8 million and \$5.7 million, respectively. Management retroactively adopted UPMIFA as of January 1, 2009.

UPMIFA also requires that OHS preserve the historic dollar value of the donor restricted endowed funds. Therefore, permanently restricted net assets contain the aggregate fair market value of (1) an endowment fund at the time it became an endowment fund, (2) each subsequent donation to the fund at the time it is made, and (3) each accumulation made pursuant to a direction in the applicable gift instrument at the time the accumulation is added to the fund.

Restricted Net Assets as of December 31, 2016, by Purpose

	Temporarily Restricted	Permanently Restricted	Total
	<i>(In Thousands)</i>		
Research	\$ 13,402	\$ 17,671	\$ 31,073
Education	5,685	3,488	9,173
Other	69,132	4,674	73,806
Total	\$ 88,219	\$ 25,833	\$ 114,052

Restricted Net Assets as of December 31, 2015, by Purpose

	Temporarily Restricted	Permanently Restricted	Total
	<i>(In Thousands)</i>		
Research	\$ 11,707	\$ 17,165	\$ 28,872
Education	5,643	3,431	9,074
Other	49,335	3,167	52,502
Total	\$ 66,685	\$ 23,763	\$ 90,448

Ochsner Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**11. Endowment Funds and Temporarily and Permanently Restricted Net Assets
(continued)**

Endowment Net Asset Composition by Type of Fund as of December 31, 2016					
	Temporarily Restricted		Permanently Restricted		Total
	Unrestricted	Restricted	Restricted	Restricted	Total
	<i>(In Thousands)</i>				
Donor-restricted funds	\$ –	\$ 10,399	\$ 25,833	\$ –	\$ 36,232
Board-designated funds	1,391	–	–	–	1,391
Total	\$ 1,391	\$ 10,399	\$ 25,833	\$ –	\$ 37,623

Endowment Net Asset Composition by Type of Fund as of December 31, 2015					
	Temporarily Restricted		Permanently Restricted		Total
	Unrestricted	Restricted	Restricted	Restricted	Total
	<i>(In Thousands)</i>				
Donor-restricted funds	\$ –	\$ 8,668	\$ 23,763	\$ –	\$ 32,431
Board-designated funds	1,341	–	–	–	1,341
Total	\$ 1,341	\$ 8,668	\$ 23,763	\$ –	\$ 33,772

Changes in Endowment Net Assets for the Year Ended December 31, 2016					
	Temporarily Restricted		Permanently Restricted		Total
	Unrestricted	Restricted	Restricted	Restricted	Total
	<i>(In Thousands)</i>				
Beginning balance	\$ 1,341	\$ 8,668	\$ 23,763	\$ –	\$ 33,772
Investment gain	87	2,300	8	–	2,395
Contributions	–	5	2,042	–	2,047
Appropriations for expenditures	(37)	(554)	–	–	(591)
Transfers	–	(20)	20	–	–
Ending balance	\$ 1,391	\$ 10,399	\$ 25,833	\$ –	\$ 37,623

Ochsner Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

11. Endowment Funds and Temporarily and Permanently Restricted Net Assets (continued)

Changes in Endowment Net Assets for the Year Ended December 31, 2015				
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
	<i>(In Thousands)</i>			
Beginning balance	\$ 1,378	\$ 8,859	\$ 23,397	\$ 33,634
Investment (loss) gain	(10)	40	(2)	28
Contributions	–	1	339	340
Appropriations for expenditures	(27)	(203)	–	(230)
Transfers	–	(29)	29	–
Ending balance	\$ 1,341	\$ 8,668	\$ 23,763	\$ 33,772

Funds With Deficiencies

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or current law requires OHS to retain as a fund of perpetual duration. In accordance with U.S. GAAP, deficiencies of this nature are reported in unrestricted net assets. There were no such deficiencies as of December 31, 2016. Such deficiencies totaled approximately \$2,000 as of December 31, 2015. Any such deficiencies resulted from unfavorable market fluctuations.

Return Objectives and Risk Parameters

OHS has investment and spending practices for endowment assets that intend to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that OHS must hold in perpetuity or for a donor-specified period(s) as well as board-designated funds. The policy allows the endowment assets to be invested in a manner that is intended to produce results that exceed the price and yield results of the allocation index while assuming a moderate level of investment risk. OHS expects its endowment funds to provide a rate of return that preserves the gift and generates earnings to achieve the endowment purpose.

Ochsner Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

11. Endowment Funds and Temporarily and Permanently Restricted Net Assets (continued)

Strategies Employed for Achieving Objectives

To satisfy its long-term rate-of-return objectives, OHS relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and interest and dividend income. OHS uses a diversified asset allocation to achieve its long-term return objectives within prudent risk constraints to preserve capital.

Spending Policy and How the Investment Objectives Relate to Spending Policy

It is OHS' objective to establish a payout rate from endowment accounts that provides a stable, predictable level of spending for the endowed purposes that will increase with the rate of inflation, and to continue to invest in accordance with policy goals of providing for a rate of growth in the endowment earnings that meets or exceeds the rate of inflation. The annual spending appropriation will be subject to a minimum rate of 4% and a maximum rate of 7% of each endowment fund's current market value. Temporarily restricted net assets, along with other donor-restricted funds, include the spending appropriation and investment income of the endowments and are pending appropriation for expenditure consistent with the specific purpose of the fund.

12. Business Combinations, Strategic Partnership, and Affiliation Agreements

Business Combinations

During 2016 and 2015, OCF completed several physician practice acquisitions, none of which were material to the results of operations. In 2016, OCF also purchased 100% of the equity interest of Sculpting Center of New Orleans, LLC for \$0.7 million.

Subsequent Event

On January 9, 2017, OCF completed the acquisition of Millennium Healthcare Management, Inc. (MHM). MHM is a leading provider of urgent care and occupational medicine in Louisiana and consists of 12 urgent care and 4 occupational health clinics. Under the terms of the acquisition, OCF paid approximately \$31.3 million in cash. Results of operations of MHM will be included in OHS' consolidated financial statements from the date of acquisition.

Ochsner Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

12. Business Combinations, Strategic Partnership, and Affiliation Agreements (continued)

Strategic Partnerships and Affiliation Agreements

In recent years, OHS has entered into several strategic partnership and affiliation agreements. While the direct financial impact of these agreements is not material, they are a component of OHS' efforts to increase local access to care, improve quality, reduce the cost of healthcare, and share best practices and resources in order to improve the health of Louisiana communities. OHS now has strategic partnerships and clinical affiliations with Lafayette General Health, CHRISTUS Health Louisiana, IASIS Glenwood Regional Medical Center, and Southwest Mississippi Regional Medical Center.

OHS and OCF also have Joint Operating Agreements (JOA) with St. Tammany Parish Hospital (STPH), Terrebonne General Medical Center (TGMC), and Slidell Memorial Hospital (SMH). These JOAs are intended to coordinate resources with the goal of lowering costs, improving quality, and creating a seamless clinical environment for patients in each of their respective local regions. STPH, TGMC, and SMH all remain public hospitals governed by their respective Boards. OCF is financially integrated with these hospitals and recognizes other operating revenue or other operating expense related to the JOAs in its consolidated statements of operations.

OCF also provides management assistance and support for Chabert and SCPH. Under these management agreements, OCF receives management fees and any excess of revenues over expenses generated by each of the facilities annually, as well as reimbursement of purchased services incurred on behalf of the facilities. OCF also has management agreements with Hancock and an interim management agreement with SBPH. Under its management agreements with Hancock and SBPH, OCF receives management fees as well as reimbursement of expenses incurred for providing management assistance and support services.

In October 2016, OCF entered into a professional services agreement with Adeptus Health, Inc. (Adeptus) to enhance access to emergency medical care in Louisiana. Ochsner opened a freestanding emergency department in Marrero, Louisiana, and Adeptus managed the operations. On March 30, 2017, OCF and Adeptus terminated this agreement and the previously established joint venture for a payment to Adeptus of approximately \$1.2 million.

Ochsner Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

13. Equity Method Investments and Joint Ventures

Investment in Equity Investees

OHS' investment in unconsolidated affiliates at December 31 and its income from equity investees for the years then ended are as follows (in thousands):

2016	Ownership Interest	Investment in Equity Investees	Equity in Income of Equity Investees
Southeast Louisiana Homecare LLC	25%	\$ 3,176	\$ 359
Louisiana Extended Care Hospital of Kenner, LLC	25%	82	123
OSR Louisiana, LLC	49%	–	(252)
Ochsner-Acadia, LLC	25%	6,994	–
		\$ 10,252	\$ 230

2015	Ownership Interest	Investment in Equity Investees	Equity in Income of Equity Investees
Southeast Louisiana Homecare LLC	25%	\$ 2,565	\$ 309
Louisiana Extended Care Hospital of Kenner, LLC	25%	380	42
		\$ 2,945	\$ 351

On June 15, 2015, OCF entered into a joint venture with Pennsylvania-based Select Medical Corporation to jointly open a new, 60-bed, acute inpatient rehabilitation hospital in 2016. Construction began in early 2016. The new partnership will initially focus on managing OCF's current acute rehab services provided in a 29-bed unit, which is licensed separately as a hospital, within the Ochsner Medical Center-Elmwood Campus. This joint venture did not have material operations during the year ended December 31, 2016.

Ochsner Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

13. Equity Method Investments and Joint Ventures (continued)

On May 17, 2016, OCF formed a joint venture with Acadia Healthcare (Acadia) to open and operate to an 82-bed behavioral health facility in Laplace, Louisiana. Ochsner contributed the facility and recorded a gain of \$6,994 for a 25% interest in the joint venture and Acadia will contribute the facility build out, equipment and working capital. Construction began in 2016 and the facility is estimated to open in 2018. This joint venture did not have any operations during the year ended December 31, 2016.

14. Electronic Health Records Services Agreements

In order to develop a better clinical integration and provide cost savings for our JOA partners, OCF has entered into electronic health records services and hosting agreements to implement and support a common EHR system. During 2015, OCF implemented its EHR system at STPH and continues to host and maintain it. In December 2015, OCF entered into a similar agreement with TGMC and implemented its EHR system during 2016 and 2017. These agreements were not material to OCF's operating income for 2016 or 2015.

15. Functional Expenses

OHS provides general health care services primarily to residents within its geographic location. Expenses related to providing these services for the years ended December 31 are as follows (in thousands):

	<u>2016</u>	<u>2015</u>
Health care services	\$ 1,902,533	\$ 1,714,394
General and administrative	790,743	743,479
Medical education	38,716	38,797
Research	13,999	13,423
Fitness center	12,310	11,894
Hotel	3,546	3,430
	<u>\$ 2,761,847</u>	<u>\$ 2,525,417</u>

Ochsner Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

16. Supplemental Disclosures of Cash Flow Information

	Year Ended December 31,	
	2016	2015
Cash paid for interest (net of amounts capitalized)	\$ 52,567	\$ 46,668
Supplemental non-cash investing and financing activities:		
Property purchases included in accounts payable	\$ 14,625	\$ 5,598
Property purchases financed by capital leases and long-term debt	\$ 6,474	\$ 8,051

17. Commitments and Contingencies

Professional and General Liability Insurance

Professional and general liability claims have been asserted against OHS by various claimants. The claims are in various stages of processing, and some may ultimately be brought to trial. Incidents occurring through December 31, 2016, may result in the assertion of additional claims.

OCF participates in a risk management program to provide for professional and general liability coverage.

Under this program, OCF carries professional and general liability insurance coverage for up to \$65.0 million each of annual aggregate claims subject to certain deductible provisions. OCF is self-insured with respect to the first \$3.0 million of each claim for professional liability with an annual aggregate exposure of \$6.0 million. General liability claims are subject to a retention of \$1.0 million per claim and \$2.0 million annual aggregate. OHS also carries additional coverage on certain community hospitals that carry similar coverage with lower self-retention and aggregate levels.

Professional liability claims are limited by Louisiana statute to \$500,000 per occurrence, the first \$100,000 of which is payable by the health care provider and the remainder of which is payable by the Patient's Compensation Fund (the Fund) for participants in the Fund. The Fund was established by the Medical Malpractice Act (the Act), which was enacted in 1975 by the State of Louisiana. The Act established the Fund and limited recovery in medical malpractice cases to \$500,000. The limitation on recovery has been challenged and, to date, successfully defended in

Ochsner Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

17. Commitments and Contingencies (continued)

the courts. Expenditures recorded by OHS for participation in the Fund for the years ended December 31, 2016 and 2015, were approximately \$17.9 million and \$19.8 million, respectively, and are included in other operating expenses in the accompanying consolidated statements of operations.

OCF has an established trust fund held by a financial institution. Disbursements are made from the trust fund for self-insured professional and general liability claims, claims administration costs, and legal fees. The amounts to be contributed to the trust funds are determined annually by an independent actuary. The trust fund assets for OCF in the aggregate totaled approximately \$9.1 million and \$11.9 million at December 31, 2016 and 2015, respectively. The trust fund assets are included in assets limited as to use under self-insurance trust fund in the accompanying consolidated balance sheets. The estimated liability recorded by OCF in the aggregate for claims, based on the actuarial report, is approximately \$13.8 million with no estimated reinsurance recoveries at December 31, 2016, and \$14.0 million with no estimated reinsurance recoveries at December 31, 2015. The estimated liability is included in other current liabilities and other long-term liabilities in the accompanying consolidated balance sheets. The estimated liability for OCF was discounted at approximately 2.5% at both December 31, 2016 and 2015. If the risk management program is terminated, the trust fund balances, if any, revert to OCF after satisfaction of outstanding claims. Any proceeds from such a reversion would be used to reduce future costs for liability coverage.

Estimated Workers' Compensation and Employee Health Claims

OHS is self-insured for workers' compensation and employee health claims. The estimated liability for workers' compensation and employee health claims totaled approximately \$18.8 million at both December 31, 2016 and 2015, which is included in accrued salaries, wages, and benefits; other current liabilities; and other long-term liabilities in the accompanying consolidated balance sheets.

Property Insurance

OHS carries property insurance coverage through third-party insurers. The policy limit is \$750.0 million and is subject to a deductible of \$250,000 per occurrence for property damage and 24 hours for the time element. The Named Wind sublimit is \$160.0 million. The Named Wind deductible is 3% for property damage and 72 hours for the time element, subject to a minimum of \$500,000 and a maximum of \$50.0 million. OHS also carried coverage on certain community hospitals with self-retention and aggregate levels.

Ochsner Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

17. Commitments and Contingencies (continued)

Lease Commitments

OHS leases certain software and equipment under capital leases. The capital lease obligations are included in other current liabilities and other non-current liabilities in the accompanying consolidated balance sheets.

Additionally, OHS leases assets under various rental agreements. OHS leases have varying terms, which may include renewal or purchase options and escalation clauses that are factored into determining minimum lease payments. The following schedule summarizes OHS' future annual minimum rental commitments on outstanding leases as of December 31, 2016 (in thousands):

	Lease Obligations	
	Capital	Operating
2017	\$ 5,774	\$ 34,905
2018	4,801	29,239
2019	2,624	22,626
2020	1,532	17,955
2021	180	16,150
Thereafter	–	102,619
Total minimum lease payments	14,911	\$ 223,494
Less amounts representing interest	(845)	
	14,066	
Less current maturities	(5,400)	
Capital lease obligations – non-current	\$ 8,666	

Rent expense, which relates primarily to cancelable or short-term operating leases for equipment and buildings, was approximately \$53.5 million and \$48.3 million for the years ended December 31, 2016 and 2015, respectively.

Ochsner Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

17. Commitments and Contingencies (continued)

Operating Leases – Lessor

OHS leases office space to other businesses. Lease terms generally range from one to four years, with options of renewal for additional periods. All such property leases provide for minimum annual rentals, and all rental revenue has been recorded on a straight-line basis. Following is a schedule by years of future minimum rental payments under non-cancelable operating leases as of December 31, 2016 (in thousands):

Years ending December 31:	
2017	\$ 7,859
2018	5,927
2019	2,581
2020	1,097
2021	874
Thereafter	6,831
Total minimum lease payments to be received	<u>\$ 25,169</u>

Contingencies

The health care industry as a whole is subject to numerous complex laws and regulations of federal, state, and local governments. Compliance with these laws and regulations can be subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time. Such compliance with laws and regulations in the health care industry has come under increased government scrutiny. OHS and its subsidiaries are parties to various legal proceedings and potential claims arising in the ordinary course of their business. Management of OHS believes the reserves it has established for these issues are adequate and does not believe, based on current facts and circumstances and after review with counsel, that these matters will have a material adverse effect on OHS' consolidated statements of financial position or results of operations.

Ochsner Health System and Subsidiaries

Notes to Consolidated Financial Statements (continued)

17. Commitments and Contingencies (continued)

The Tax Relief and Health Care Act of 2006 authorized a permanent program involving the use of third-party recovery audit contractors (RACs) to identify Medicare and Medicaid overpayments and underpayments made to providers. RACs are compensated based on the amount of both overpayments and underpayments they identify by reviewing claims submitted to Medicare for correct coding and medical necessity. Payment recoveries resulting from RAC reviews are appealable through administrative and judicial processes. Payment recoveries and denials resulting from RAC reviews can be appealed through administrative and judicial processes, and management intends to pursue the reversal of adverse determinations where appropriate. In addition to overpayments that are not reversed on appeal, OHS will incur additional costs to respond to requests for records and to pursue the reversal of payment denials. OHS expects the RACs will continue to seek CMS approval to review additional issues.

Management of OHS believes that the reserves it has established for RAC reviews, which are included in other long-term liabilities in the accompanying consolidated balance sheets, are adequate but cannot predict with certainty the impact of the Medicare and Medicaid RAC program on its future consolidated results of operations or cash flows.

18. Subsequent Events

OHS has evaluated subsequent events through April 24, 2017, the date the accompanying consolidated financial statements were available for issuance.

Ochsner Health System and Subsidiaries

Schedule of Compensation Information

Year Ended December 31, 2016

Chief Executive Officer: Warner L. Thomas

None of the Chief Executive Officer's compensation is paid from public funds received by Ochsner Health System and subsidiaries.



Ernst & Young LLP
3900 One Shell Square
701 Poydras Street
New Orleans, LA 70139

Tel: +1 504 581 4200
Fax: +1 504 596 4233
ey.com

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

The Board of Directors and Management
Ochsner Health System and Subsidiaries

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 Ochsner Health System and its subsidiaries (Ochsner Health System), which comprise the consolidated balance sheet as of December 31, 2016, and the related consolidated statements of operations, 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 April 24, 2017.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Ochsner Health System'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 Ochsner Health System's internal control. Accordingly, we do not express an opinion on the effectiveness of Ochsner Health System'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 Ochsner Health System'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

April 24, 2017

Report of Independent Auditors on Compliance for the Major Federal Program; Report on Internal Control Over Compliance and Report on Schedule of Expenditures of Federal Awards Required by the Uniform Guidance

The Board of Directors and Management
Ochsner Health System and Subsidiaries

Report on Compliance for the Major Federal Program

We have audited Ochsner Health System and its subsidiaries' (Ochsner Health System) 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 Ochsner Health System's major federal program for the year ended December 31, 2016. Ochsner Health System's major federal program is 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 statutes, regulations and the terms and conditions of its federal awards applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for Ochsner Health System's major federal program 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). Those standards and the Uniform Guidance 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 program occurred. An audit includes examining, on a test basis, evidence about Ochsner Health System'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 the major federal program. However, our audit does not provide a legal determination of Ochsner Health System's compliance.

Opinion on the Major Federal Program

In our opinion, Ochsner Health System complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on its major federal program for the year ended December 31, 2016.

Report on Internal Control Over Compliance

Management of Ochsner Health System 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 Ochsner Health System's internal control over compliance with the types of requirements that could have a direct and material effect on its major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for the major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, 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 Ochsner Health System'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 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 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 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. Accordingly, this report is not suitable for any other purpose.



Report on Schedule of Expenditures of Federal Awards Required by the Uniform Guidance

We have audited the financial statements of Ochsner Health System as of and for the year ended December 31, 2016, and have issued our report thereon dated April 24, 2017, which contained an unmodified opinion on those financial statements. Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by the Uniform Guidance and is not a required part of the 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 financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the schedule of expenditure of federal awards is fairly stated in all material respects in relation to the financial statements as a whole.

Ernst + Young LLP

June 23, 2017

Ochsner Health System and Subsidiaries
 Schedule of Expenditures of Federal Awards

Year Ended December 31, 2016

Federal Grantor/Pass-Through Grantor/Program Title	Federal CFDA Number	Pass-Through Entity Identifying Number	Research and Development Cluster	Other Federal Expenditures	Total Federal Expenditures	Amounts Provided to Subrecipients
U.S. Department of Education						
Pass-Through From:						
<i>Louisiana Department of Education</i>						
Special Education _Grants to States	84.027	H027A160033	\$ -	\$ 11,923	\$ 11,923	\$ 11,923
Total U.S. Department of Education			-	11,923	11,923	11,923
U.S. Department of Health and Human Services						
Direct Awards:						
National Center for Advancing Translational Sciences Cancer Treatment Research	93.350	-	256,404	-	256,404	40,654
	93.395	-	481,024	-	481,024	-
Pass-Through From:						
<i>Duke University/Duke Clinical Research Institute</i>						
Food & Drug Administration_Research	93.103	R18FD005292	12,918	-	12,918	-
<i>Tulane University Health Science Center</i>						
Environmental Health	93.113	TUL-HSC-553302-15/16	4,963	-	4,963	-
<i>University of Pittsburgh</i>						
Minority Health and Health Disparities Research	93.307	004119 (124864-19)	9,313	-	9,313	-
<i>American College of Radiology Imaging Network</i>						
Cancer Detection and Diagnosis Research	93.394	U01CA080098	171	-	171	-
<i>Alliance for Clinical Trials in Oncology</i>						
Cancer Treatment Research	93.395	1U10CA180821	408	-	408	-

Ochsner Health System and Subsidiaries

Schedule of Expenditures of Federal Awards (continued)

Federal Grantor/Pass-Through Grantor/Program Title	Federal CFDA Number	Pass-Through Entity Identifying Number	Research and Development Cluster	Other Federal Expenditures	Total Federal Expenditures	Amounts Provided to Subrecipients
U.S. Department of Health and Human Services (continued)						
Pass-Through From:						
<i>Children's Hospital of Philadelphia</i>						
Cancer Treatment Research	93.395	U10CA180886	\$ 110	\$ -	\$ 110	\$ -
<i>Duke University</i>						
Cancer Treatment Research	93.395	7U10CA76001-4 U10CA86004-2	907	-	907	-
<i>Brigham and Women's Hospital</i>						
Cancer Treatment Research	93.395	5U10CA025224	1,486	-	1,486	-
<i>NRG Oncology Foundation, Inc.</i>						
Cancer Treatment Research	93.395	U10 CA0037422	404	-	404	-
<i>Total CFDA 93.395</i>			3,315	-	3,315	-
<i>Eastern Cooperative Oncology Group</i>						
Cancer Control	93.399	3U10 CA37403-15	56,728	-	56,728	-
<i>Southeastern Louisiana Area Health Education Center</i>						
Strong Start for Mothers and Newborns	93.611	CMS-1D1-12-001	-	34,114	34,114	-
<i>Louisiana Health Care Quality Forum</i>						
Health Information Technology Regional Extension Centers Program	93.718	90RC0049/01	-	3,420	3,420	-
<i>Brigham and Women's Hospital</i>						
Cardiovascular Diseases Research	93.837	1U01HL130163-01	18,766	-	18,766	-
<i>Duke University/Duke Clinical Research Institute</i>						
Cardiovascular Diseases Research	93.837	4U10HL084904	3,530	-	3,530	-

Ochsner Health System and Subsidiaries

Schedule of Expenditures of Federal Awards (continued)

Federal Grantor/Pass-Through Grantor/Program Title	Federal CFDA Number	Pass-Through Entity Identifying Number	Research and Development Cluster	Other Federal Expenditures	Total Federal Expenditures	Amounts Provided to Subrecipients
U.S. Department of Health and Human Services (continued)						
Pass-Through From:						
<i>University of Alabama</i>						
Cardiovascular Diseases Research	93.837	000503570-005	\$ 34,823	\$ -	\$ 34,823	\$ -
<i>New England Research Institutes, Inc.</i>						
Cardiovascular Diseases Research	93.837	U01HL107407	15,436	-	15,436	-
<i>Total CFDA 93.837</i>			72,555	-	72,555	-
<i>University of South Florida</i>						
Diabetes, Digestive, and Kidney Diseases Extramural Research	93.847	1UC4DK097835-01	4,352	-	4,352	-
<i>University of Medicine and Dentistry of New Jersey</i>						
Extramural Research Programs in the Neurosciences and Neurological Disorders	93.853	5R01 NS38384-08	2,129	-	2,129	-
<i>Regents of the University of Minnesota</i>						
Extramural Research Programs in the Neurosciences and Neurological Disorders	93.853	N003439224	2,678	-	2,678	-
<i>Mayo Clinic Jacksonville</i>						
Extramural Research Programs in the Neurosciences and Neurological Disorders	93.853	1U01NS08168-01A1/5U01N5080168-03	49,018	-	49,018	-
<i>Massachusetts General Hospital</i>						
Extramural Research Programs in the Neurosciences and Neurological Disorders	93.853	5U01NS090259-02	5,768	-	5,768	-
<i>Total CFDA 93.853</i>			59,593	-	59,593	-
<i>The Johns Hopkins University</i>						
Allergy and Infectious Diseases Research	93.855	1U01AI109657-01/5U01AI109657-02/03	3,229	-	3,229	-
<i>National Institute of Allergy & Infectious Diseases</i>						
Allergy and Infectious Diseases Research	93.855	UM1AI104681	5,597	-	5,597	-
<i>Total CFDA 93.855</i>			8,826	-	8,826	-

Ochsner Health System and Subsidiaries

Schedule of Expenditures of Federal Awards (continued)

Federal Grantor/Pass-Through Grantor/Program Title	Federal CFDA Number	Pass-Through Entity Identifying Number	Research and Development Cluster	Other Federal Expenditures	Total Federal Expenditures	Amounts Provided to Subrecipients
U.S. Department of Health and Human Services (continued)						
<i>Louisiana Hospital Association Research & Education Foundation</i>						
National Bioterrorism Hospital Preparedness Program	93.889	2014-2015 (Round 13)	\$ -	\$ 4,403	\$ 4,403	\$ -
<i>Louisiana Hospital Association Research & Education Foundation</i>						
National Bioterrorism Hospital Preparedness Program	93.889	2015-2016 (Round 14)	-	29,579	29,579	-
<i>Total CFDA 93.889</i>						
Total U.S. Department of Health and Human Services			970,162	71,516	1,041,678	40,654
Total Expenditures of Federal Awards			<u>\$ 970,162</u>	<u>\$ 83,439</u>	<u>\$ 1,053,601</u>	<u>\$ 52,577</u>

See accompanying notes to schedule of expenditures of federal awards.

Ochsner Health System and Subsidiaries

Notes to Schedule of Expenditures of Federal Awards

Year Ended December 31, 2016

1. General

The schedule of expenditures of federal awards (SEFA) includes the federal award activity of Ochsner Health System under programs of the federal government for the year ended December 31, 2016. The information in the SEFA is presented in accordance with Title 2 U.S. Code of Federal Regulations Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance).

2. Basis of Accounting

Expenditures reported on the SEFA are reported on the accrual basis of accounting in accordance with U.S. generally accepted accounting principles. Expenditures are recognized following the cost principles contained in the Uniform Guidance or OMB Circular A-122, *Cost Principles for Non-Profit Organizations*. Therefore, some amounts presented in the SEFA may differ from amounts presented in, or used in the preparation of, the consolidated financial statements.

3. Indirect Cost Rate

Ochsner Health System did not use the 10% de minimis indirect cost rate allowed by the Uniform Guidance.

Ochsner Health System and Subsidiaries

Schedule of Findings and Questioned Costs

For the Year Ended December 31, 2016

Section I—Summary of Auditor’s Results

Financial Statements

Type of report the auditor 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 federal 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**

Identification of major federal programs

CFDA Number(s)

Name of Federal Program or Cluster

93.103, 93.113, 93.307, 93.350, 93.394, 93.395, 93.399, 93.837, 93.847, 93.853, 93.855

Research and Development Cluster

Dollar threshold used to distinguish between Type A and Type B programs:

\$ 750,000

Auditee qualified as low-risk auditee?

_____ **yes** X **no**

Ochsner Health System and Subsidiaries

Schedule of Findings and Questioned Costs (continued)

Section II—Financial Statement Findings

There were no financial statement findings.

Section III—Federal Award Findings and Questioned Costs

There were no federal award findings or questioned costs.

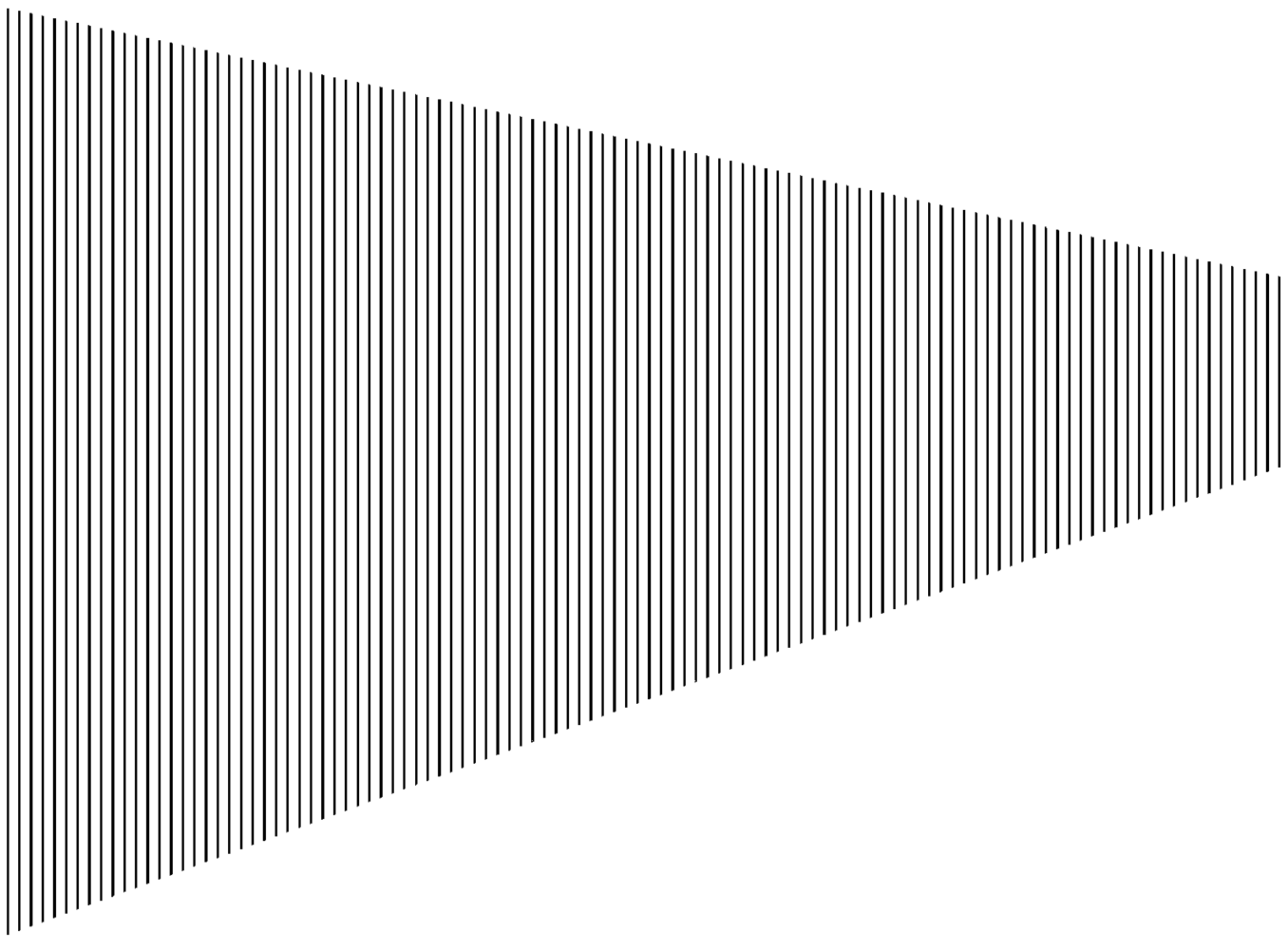
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Summary Schedule of Prior Audit Findings

For the Year Ended December 31, 2016

Finding 2015-001 – Material Weakness – Schedule of Expenditures of Federal Awards (SEFA) Preparation – Reporting

Status: Corrected.

No findings were noted in 2014.

Ochsner Health System, a part of Ochsner Clinic Foundation

1514 Jefferson Highway • New Orleans, LA 70121 • phone 504-842-3000 • www.ochsner.org