Consolidated Financial Statements and Supplementary Information

CHRISTUS Health
Fiscal Years Ended June 30, 2018 and 2017
With Reports of Independent Auditors

Ernst & Young LLP

Building a better working world

CHRISTUS Health

Consolidated Financial Statements
and Supplementary Information

Fiscal Years Ended June 30, 2018 and 2017

Contents

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Report of Independent Auditors

The Board of Directors
CHRISTUS Health

We have audited the accompanying consolidated financial statements of CHRISTUS Health, which comprise the consolidated balance sheets as of June 30, 2018 and 2017, and the related consolidated statements of operations and changes in net assets and cash flows for the fiscal years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

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Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of CHRISTUS Health at June 30, 2018 and 2017, and the consolidated results of its operations and its cash flows for the fiscal years then ended in conformity with U.S. generally accepted accounting principles.

Ernst & Young LLP

September 20, 2018

CHRISTUS Health

Consolidated Balance Sheets

	June 30 2018	June 30 2017
	(In Thousands)	
Assets		
Current assets:		
Cash and cash equivalents	**$ 398,086**	$ 528,259
Short-term investments and equity in managed funds	**691,407**	586,560
Assets whose use is limited or restricted, required for current liabilities	**64,869**	58,831
Patient accounts receivable, net of allowance for doubtful accounts of $426,732 and $310,089 at June 30, 2018 and 2017, respectively	**525,316**	505,480
Notes and other receivables	**201,740**	207,012
Inventories	**112,448**	105,104
Other current assets	**84,389**	103,142
Total current assets	**2,078,255**	2,094,388
Assets whose use is limited or restricted, less current portion	**751,947**	709,925
Property and equipment, net of accumulated depreciation	**2,582,819**	2,358,676
Other assets:		
Investments in unconsolidated organizations	**200,059**	150,823
Goodwill and intangible assets, net	**163,275**	132,668
Beneficial interest in supporting organizations and other restricted assets	**103,398**	87,730
Other assets, including notes receivable from related party	**175,405**	202,173
Total other assets	**642,137**	573,394
Total assets	**$ 6,055,158**	$ 5,736,383

	June 30 2018	June 30 2017
	(In Thousands)	
Liabilities and net assets		
Current liabilities:		
Accounts payable and accrued expenses	**$ 641,628**	$ 631,663
Accrued employee compensation and benefits	**279,603**	252,139
Current portion of long-term debt	**51,359**	44,880
Total current liabilities	**972,590**	928,682
Long-term debt, less current portion	**1,246,875**	1,117,125
Accrued pension benefits	**109,868**	170,356
Derivative financial instruments	**86,120**	116,160
Other long-term obligations – including self-funded liabilities, less current portion	**237,537**	227,601
Total liabilities	**2,652,990**	2,559,924
Net assets		
Unrestricted:		
Attributable to CHRISTUS Health	**2,963,671**	2,798,703
Attributable to non-controlling interest	**238,122**	201,855
Total unrestricted	**3,201,793**	3,000,558
Temporarily restricted	**182,770**	159,021
Permanently restricted	**17,605**	16,880
Total net assets	**3,402,168**	3,176,459
Total liabilities and net assets	**$ 6,055,158**	$ 5,736,383

See accompanying notes.

CHRISTUS Health

Consolidated Statements of Operations and Changes in Net Assets

	Year Ended June 30	
	2018	**2017**
	(In Thousands)	
Revenues:		
Patient service revenue (net of contractual allowances and discounts)	**$ 5,338,351**	$ 4,844,925
Provision for bad debts	**(540,390)**	(459,803)
Net patient service revenue less provision for bad debts	**4,797,961**	4,385,122
Premium revenue	**297,553**	216,706
Inherent contribution from business combination	**15,000**	73,101
Other revenue including gain on contribution to joint venture	**274,712**	238,385
Equity in (losses) income of unconsolidated organizations	**(10,601)**	9,115
Total revenues	**5,374,625**	4,922,429
Expenses:		
Employee compensation and benefits	**2,434,927**	2,247,498
Services and other	**1,613,721**	1,506,767
Supplies	**925,311**	834,718
Depreciation and amortization, including impairment	**234,168**	215,039
Interest	**43,233**	37,167
Total expenses	**5,251,360**	4,841,189
Operating income	**123,265**	81,240
Nonoperating investment gain, net	**52,750**	95,388
Other nonoperating loss	**(1,605)**	(3,524)
Revenues in excess of expenses	**174,410**	173,104
Less revenues in excess of expenses attributable to non-controlling interests	**32,401**	31,735
Revenues in excess of expenses attributable to CHRISTUS Health	**142,009**	141,369

CHRISTUS Health

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

	Year Ended June 30	
	2018	**2017**
	(In Thousands)	
Unrestricted net assets:		
Revenues in excess of expenses attributable to CHRISTUS Health	**$ 142,009**	$ 141,369
Unrealized gain on investments	**2,235**	3,427
Change in pension liabilities	**41,204**	20,688
Change in non-controlling interest	**36,267**	49,053
Net assets released from restrictions for capital and other	**(20,480)**	34,176
Changes in unrestricted net assets	**201,235**	248,713
Temporarily restricted net assets:		
Temporarily restricted net assets acquired	**–**	646
Net change in beneficial interests	**14,627**	1,141
Contributions	**20,264**	23,862
Unrealized gain on investments	**606**	707
Net assets released from restrictions and other	**(11,748)**	(30,320)
Changes in temporarily restricted net assets	**23,749**	(3,964)
Permanently restricted net assets:		
Net change in beneficial interests	**676**	(131)
Other	**49**	134
Changes in permanently restricted net assets	**725**	3
Change in net assets	**225,709**	244,752
Net assets – beginning of fiscal year	**3,176,459**	2,931,707
Net assets – end of fiscal year	**$ 3,402,168**	$ 3,176,459

See accompanying notes.

CHRISTUS Health

Consolidated Statements of Cash Flows

	Year Ended June 30 2018	2017
	(In Thousands)	
Operating activities		
Change in net assets	**$ 225,709**	$ 244,752
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Inherent contribution from business combination	**(15,000)**	(73,101)
Net gain on contribution to joint ventures	**(36,340)**	–
Change in beneficial interest	**(15,303)**	1,009
Change in pension liabilities recognized in net assets	**(41,204)**	(20,688)
Contributions of temporarily restricted net assets	**(20,264)**	(23,862)
Distributions to and acquisitions of non-controlling interest, net	**20,489**	7,433
Restricted assets acquired in business combination	**–**	(646)
Non-controlling interest acquired in business combination	**(14,550)**	(20,784)
Equity in losses (income) of unconsolidated organizations	**10,601**	(9,115)
Unrealized investment loss	**21,790**	21,280
Depreciation and amortization	**234,168**	215,039
Amortization of deferred financing costs	**1,123**	1,128
Provision for bad debts	**540,390**	459,803
Change in derivative fair value	**(29,640)**	(52,360)
Loss on extinguishment of debt	**–**	1,816
(Gain) loss on disposal of property and equipment	**(333)**	483
Foreign currency translation loss (gain)	**11,675**	(7,062)
Changes in operating assets and liabilities, net of acquisitions:		
Increase in net patient accounts receivable	**(558,696)**	(466,051)
(Increase) decrease in investments	**(174,697)**	232,876
Decrease (increase) in notes and other receivables	**5,271**	(45,488)
Decrease (increase) in other current assets and inventories	**13,157**	(16,299)
Increase in accounts payable, accrued expenses, and accrued employee compensation and benefits	**50,084**	116,728
Decrease in other long-term liabilities	**(11,210)**	(43,032)
Net cash provided by operating activities	**217,220**	523,859
Investing activities		
Purchases of property and equipment	**(418,400)**	(343,689)
Proceeds from sale or disposal of property and equipment	**–**	49
Proceeds from sale of majority interest in operating activities	**24,756**	–
Proceeds and dividends from sale of equity investment in unconsolidated subsidiaries	**–**	21,570
Distributions from investments in unconsolidated organizations	**9,601**	10,722
Purchases of or contributions to investments in unconsolidated organizations	**(52,934)**	(44,683)
Notes issued to related parties	**(11,630)**	(28,370)
Decrease (increase) in other assets	**32,223**	(61,435)
Acquisitions of health care entities, net of cash acquired	**(45,328)**	23,251
Net cash used in investing activities	**(461,712)**	(422,585)

CHRISTUS Health

Consolidated Statements of Cash Flows (continued)

	Year Ended June 30 2018	2017
	(In Thousands)	
Financing activities		
Contributions of temporarily restricted net assets	**$ 20,264**	$ 23,862
Costs associated with debt refinancing/conversion	**–**	(983)
Proceeds from issuance of new debt	**164,078**	263,205
Payments on long-term debt	**(49,534)**	(335,330)
Distributions to and acquisitions of non-controlling interest, net	**(20,489)**	(7,433)
Net cash provided by (used in) financing activities	**114,319**	(56,679)
Net (decrease) increase in cash and cash equivalents	**(130,173)**	44,595
Cash and cash equivalents – beginning of fiscal year	**528,259**	483,664
Cash and cash equivalents – end of fiscal year	**$ 398,086**	$ 528,259
Noncash investing and financing transactions		
Capital lease and debt obligations incurred for property and equipment	**$ 20,541**	$ 66,682
Supplemental disclosure of cash flow information		
Cash paid during the year for interest (net of amount capitalized)	**$ 37,246**	$ 34,622

See accompanying notes.

1. Mission, Vision, and Organization of CHRISTUS Health

CHRISTUS Health was incorporated as a Texas nonprofit corporation on December 15, 1998. CHRISTUS is sponsored by the Congregation of the Sisters of Charity of the Incarnate Word of Houston, Texas; the Congregation of the Sisters of Charity of the Incarnate Word of San Antonio, Texas; and the Congregation of the Sisters of the Holy Family of Nazareth. CHRISTUS Health together with each affiliated entity for which CHRISTUS Health holds, directly or indirectly, at least a majority membership, ownership or other controlling interest are collectively referred to in these consolidated financial statements as “CHRISTUS” or “the System.”

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

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

The consolidated financial statements reflect the results of operations of CHRISTUS Health and its affiliated market-based organizations and other related entities, including but not limited to hospital foundations, professional office buildings, management services organizations, physician groups, outpatient surgery centers, diagnostic imaging companies, urgent care centers, a collection agency, self-insurance trusts, an offshore captive insurance company, health plans, and integrated community health networks, each of which is considered a CHRISTUS ministry.

CHRISTUS entities control or own, directly or indirectly, or manage various nonprofit and for-profit corporations and other organizations that currently operate domestically in the states of Texas, Louisiana, and New Mexico, and internationally in Grand Cayman, Mexico, Chile and Colombia.

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

2. Community Health

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

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

Programs and Services for the Poor and Underserved

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

Charity Care – In accordance with the Catholic Health Association (CHA) guidelines, charity care represents the unpaid costs of free or discounted health services provided to persons who cannot afford to pay and who meet the organization’s criteria for financial assistance. Traditional charity care is defined by the state of Texas as the unreimbursed costs of providing, funding, or otherwise financially supporting the health care services provided to a person with income at or below 200% of the federal poverty level. Charity care services provided to these patients are not reported as revenue in the consolidated statements of operations and changes in net assets as there is no expectation of payment. The amount of traditional charity care provided, determined on the basis of cost, estimated using the applicable cost to charge ratios of the hospital participants, excluding the provision for bad debts, was $268,435,000 and $246,550,000 for the fiscal years ended June 30, 2018 and 2017, respectively.

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

2. Community Health (continued)

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

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

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

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

3. Summary of Significant Accounting Policies

Basis of Consolidation

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

Use of Estimates

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

3. Summary of Significant Accounting Policies (continued)

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

Cash and Cash Equivalents and Investments

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

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

3. Summary of Significant Accounting Policies (continued)

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

Derivative Financial Instruments

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

Inventories

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

Property and Equipment

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

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

3. Summary of Significant Accounting Policies (continued)

Asset Impairment

The System periodically evaluates the carrying value of its operating long-lived assets and assets held for sale for impairment when indicators of impairment are identified. These evaluations are primarily based on the estimated recoverability of the assets' carrying value. Impairment write-downs are recognized as a reduction in operating income for the operating long-lived assets and as a reduction in non-operating gain for the assets held for sale at the time the impairment is identified. Impairment losses of $0 and $10,756,000 were recorded as depreciation expense in fiscal years 2018 and 2017, respectively. In determining the amount of the impairment, the fair values of the affected assets were estimated primarily using a discounted cash flow methodology.

Investments in Unconsolidated Organizations

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

Non-Controlling Interests in Consolidated Subsidiaries

The System attributed revenues in excess of expenses of $32,401,000 and $31,735,000 for the fiscal years ended June 30, 2018 and 2017, respectively, to the non-controlling interests based on the contractual terms of joint ventures and the ownership percentage of the non-controlling interests in certain of the consolidated subsidiaries. These amounts are reflected in unrestricted net assets in the consolidated balance sheets, net of distributions.

Goodwill and Intangible Assets

Goodwill and intangible assets recorded in connection with acquisitions completed by the System are accounted for under Accounting Standards Codification (ASC) 350, *Intangibles – Goodwill and Other*. The System records goodwill as the excess of the purchase price over the fair value of identifiable tangible and intangible assets acquired and liabilities assumed. Indefinite-lived intangible assets consist entirely of a trade name asset recorded in connection with the Trinity Mother Frances Health System acquisition in fiscal year 2016. Finite-lived intangible assets consist

3. Summary of Significant Accounting Policies (continued)

primarily of noncompete assets generated from prior business combinations and minimum revenue guarantees offered to various non-employed physicians throughout the System. At June 30, 2018 and 2017, the System had goodwill and intangible assets, net, of $163,275,000 and $132,668,000, respectively.

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

	Goodwill	Indefinite-Lived Asset	Finite-Lived Assets
Balance at July 1, 2016	$ 78,510	$ 46,000	$ 12,151
Assets acquired	–	–	2,777
Amortization	–	–	(4,459)
Currency translation and other adjustments	235	–	(2,546)
Balance at June 30, 2017	78,745	46,000	7,923
Assets acquired	**30,544**	**–**	**6,299**
Amortization	**–**	**–**	**(5,621)**
Currency translation and other adjustments	**(479)**	**–**	**(136)**
Balance at June 30, 2018	**$ 108,810**	**$ 46,000**	**$ 8,465**

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

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

3. Summary of Significant Accounting Policies (continued)

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

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

As a result of the quantitative and qualitative assessments for both the fiscal years ended June 30, 2018 and 2017 no impairment losses were recorded.

Indefinite-lived intangible assets are also tested annually for impairment on April 1 of each year, by comparing the fair value of the asset with its carrying amount. The System also considers facts and circumstances surrounding the asset on an annual basis to determine if an indefinite life continues to be appropriate. For indefinite-lived intangible asset impairment tests, the System also may elect to perform a qualitative assessment to determine whether facts and circumstances support a conclusion that it is more likely than not that the asset is not impaired. If the qualitative analysis is not conclusive, or if the System elects to proceed directly with quantitative testing, the fair values of the intangible assets are determined and compared to their carrying amounts. No impairment losses on indefinite-lived intangible assets were recognized in fiscal years 2018 and 2017.

Finite-lived intangible assets are tested for impairment whenever indicators of impairment are identified. An impairment loss is recognized if the intangible asset is not recoverable and its carrying amount exceeds its fair value. No impairment losses on finite-lived intangible assets were recognized in fiscal years 2018 and 2017.

3. Summary of Significant Accounting Policies (continued)

Deferred Financing Costs

Deferred financing costs, net of accumulated amortization, included as a reduction of long-term debt at June 30, 2018 and 2017, are $7,905,000 and $8,716,000, respectively, which are being amortized using the effective interest method over the terms of the indebtedness to which they relate. Amortization expense recognized for fiscal years 2018 and 2017 was $1,123,000 and $1,128,000, respectively.

Temporarily and Permanently Restricted Net Assets

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

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

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

3. Summary of Significant Accounting Policies (continued)

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

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

Provision for Bad Debts

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

Premium Revenue and Associated Costs

Premium revenue largely represents revenues derived under capitated arrangements with third parties. In return for these premiums, CHRISTUS is responsible for providing essentially all health care services to enrolled participants. The System contracts with the Department of Defense (DOD) to treat TRICARE patients through a US Family Health Plan. Premium revenue recognized under the contract with the DOD was 44.5% and 61.5% of total premium revenue at June 30, 2018 and 2017, respectively.

Premium revenues are also generated by the System's health maintenance organization, CHIP and STAR programs, Medicare Advantage plans, and for individual coverage on federal and state-based health exchanges. Premium revenue for individual coverage on the federal and state-based exchanges, Medicare Advantage, and the CHIP and STAR programs were 55.5% and 38.5% of total premium revenue for the fiscal years ended June 30, 2018 and 2017, respectively. The exchanges revenues are subject to risk-sharing provisions as outlined in federal regulations. Additionally, a significant portion of these premiums are subsidized through the federal government's advance premium tax credit provisions. The purpose of the risk-sharing provisions is to transfer funds from health plans with lower risk to health plans with higher risk within the

3. Summary of Significant Accounting Policies (continued)

same state. Risk adjustment assessments and distributions are computed based on a health plan's risk score versus the overall market risk score. Included in net premium revenues for individual coverage on federal and state-based health exchanges is a reserve for risk-sharing assessments of $5,221,000 and $15,711,000 as of June 30, 2018 and 2017, respectively. Ultimate settlement could differ significantly from this estimate.

Costs for providing services through these contracts, including services provided by other health care providers, were $242,693,000 and $187,715,000 for the fiscal years ended June 30, 2018 and 2017, respectively, and are included as operating expenses in the accompanying consolidated financial statements. At June 30, 2018 and 2017, the System has accrued expenses for incurred but not reported claims based upon actuarial evaluations of claims experience. These estimates are continually reviewed and adjusted as necessary as experience develops or as new information becomes known; such adjustments are included in current operations. The System maintains stop-loss insurance coverage to limit exposure for certain catastrophic claims.

Other Revenue

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

Income Taxes

The authoritative guidance in ASC 740, *Income Taxes*, creates a single model to address uncertainty in tax positions and clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. Under the requirements of this guidance, tax-exempt organizations could be required to record an obligation as the result of a tax position they have historically taken on various tax exposure items. CHRISTUS has interests in various taxable entities, including

3. Summary of Significant Accounting Policies (continued)

investments in Mexico and Chile. These interests may give rise to U.S. and international tax exposures. CHRISTUS intends to utilize foreign earnings in foreign operations for an indefinite period of time in order to continue investing all earnings into the continued maintenance and expansion of these operations abroad as part of the System's mission. If these amounts were distributed to the United States, in the form of dividends or otherwise, the System would be subject to additional U.S. income taxes. Determination of the amount of unrecognized deferred income tax liabilities on these earnings is not practicable because such liability, if any, depends on circumstances existing if and when remittance occurs. There are no material unrecorded tax liabilities as of June 30, 2018 and 2017.

At June 30, 2018 and 2017, CHRISTUS has operating loss carryforwards of $337,887,000 and $306,735,000, which result in deferred tax assets of $71,558,000 and $107,357,000, respectively. CHRISTUS has provided a valuation allowance of the same amount as it is more likely than not that the deferred tax assets will not be realized.

The Tax Cuts and Jobs Act (the Act) was enacted on December 22, 2017. The provisions of the Act do not have a material tax effect on the System's consolidated financial statements. The Act reduces the U.S. federal corporate tax rate from 35% to 21%. For tax-exempt entities, the Act also requires organizations to categorize certain fringe benefit expenses as a source of unrelated business income, pay an excise tax on remuneration above certain thresholds that is paid to certain executives by the organizations, and report income or loss from unrelated business activities on an activity-by-activity basis, among other provisions. Certain regulatory guidance provides for a measurement period of up to one year during which accounting for the tax effects of the Act may be completed. The System will continue to evaluate the impact of the Act and may record adjustments as additional information and guidance is released by the IRS.

Business Combinations

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

3. Summary of Significant Accounting Policies (continued)

and measure the consideration transferred, the assets acquired, the liabilities assumed and any non-controlling interests has been obtained, limited to one year from the acquisition date) are recorded in the period in which the final amounts are determined. Goodwill is determined as the excess of the purchase price over the fair value of identifiable tangible and intangible assets acquired and liabilities assumed. An inherent contribution is recorded if the fair value of identifiable assets and liabilities acquired exceed the consideration conveyed.

New and Pending Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, enacting ASC 606, *Revenue from Contracts with Customers (*ASU 2014-09*)*, to clarify the principles for recognizing revenue and to improve financial reporting by creating common revenue recognition guidance for U.S. GAAP and International Financial Reporting Standards (IFRS). The core principle of the new guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. CHRISTUS has evaluated the requirements of the new standard to ensure processes have been put in place to collect the necessary information to implement the standard, which became effective for CHRISTUS on July 1, 2018. The System used a modified retrospective method of application to adopt ASU 2014-09 on July 1, 2018. For patient revenues, a portfolio approach was used to apply the model to classes of payers with similar characteristics. Adoption of ASU 2014-09 will result in changes to the presentation and disclosure of revenue related to uninsured or underinsured patients. Prior to adoption of 2014-09, a significant portion of the provision for bad debts related to self-pay patients, as well as co-pays and deductibles owed by patients with insurance. Under ASU 2014-09, the estimated uncollectible amounts due from these patients are generally considered a direct reduction to patient service revenue resulting in a material reduction in the amounts presented separately as provision for bad debts. CHRISTUS also assessed of the impact of the new standard on various reimbursement programs that represent variable consideration and concluded that accounting for these programs under the new standard is substantially consistent with the current accounting practices, although industry guidance is continuing to develop. These include supplemental state Medicaid programs, disproportionate share payments and settlements with third-party payers. While the adoption of ASU 2014-09 will have a material effect on the presentation of patient service revenue in the consolidated statements of operations and changes in net assets and will impact certain disclosures, the System does not believe it will not materially impact the financial position, results of operations or cash flows.

3. Summary of Significant Accounting Policies (continued)

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

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

In November 2016, the FASB issued ASU 2016-18, *Restricted Cash*, as an update to ASC 230, *Statement of Cash Flows*. This update requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. The updated guidance will be effective for annual periods beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. Early adoption is permitted, including adoption in an interim period. The new guidance should be applied on a retrospective basis. The updated guidance will result in a change in the cash flow statement to include restricted cash and restricted cash equivalents. No other material impact is expected.

In January 2017, the FASB issued ASU 2017-04, *Simplifying the Test for Goodwill Impairment*, as an update to ASC 350, *Intangibles – Goodwill and Other*. This update eliminates step 2 of the goodwill impairment test, which required an entity to determine the fair value of individual assets and liabilities of the reporting unit. Under this updated guidance, the impairment amount will be determined using the step 1 comparison of fair value to carrying value. The updated guidance will

3. Summary of Significant Accounting Policies (continued)

be effective for the annual and any interim goodwill impairment tests in fiscal years beginning after December 15, 2021. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The adoption of the guidance is not expected to have a material impact to the System's consolidated financial statements.

In March 2017, the FASB issued ASU 2017-07, *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. This update changes the presentation requirements of net periodic pension and postretirement benefit costs in the statement of operations and changes in net assets by requiring the service cost component to be presented as part of compensation expense and the remaining components to be presented separately from the service cost component and outside a subtotal of income from operations. The updated guidance is effective for annual periods beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. The new guidance should be applied on a retrospective basis, and early adoption is permitted. The updated guidance will affect the classification of expense within the System's consolidated statement of operations and changes in net assets and no other material impact is expected.

In June 2018, the FASB issued ASU 2018-08, *Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*. This update clarifies and improves current guidance about whether a transfer of assets is a contribution or an exchange transaction. The updated guidance is effective for annual periods beginning after June 15, 2018, including interim period within that annual period. The new guidance should be applied on a modified prospective basis, and early adoption is permitted. The adoption of the guidance is not expected to have a material impact to the System's consolidated financial statements.

Performance Indicator

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

3. Summary of Significant Accounting Policies (continued)

Operating and Nonoperating Activities

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

Reclassifications

Certain prior year amounts have been reclassified to conform to the current year presentation. Estimated third party settlements, net of $62,782,000 as of June 30, 2017, have been included in accounts payable and accrued expenses.

4. Net Patient Service Revenue and Patient Accounts Receivable

Net Patient Service Revenue

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

	2018 Patient Service Revenue	**% of Total**	**2017 Patient Service Revenue**	**% of Total**
Medicare	**$ 1,249,881**	**23%**	$ 1,171,251	24%
Medicaid	**534,178**	**10**	427,939	9
Managed care	**2,073,741**	**39**	1,950,343	40
Commercial	**476,699**	**9**	390,429	8
Other, including self-pay	**1,003,852**	**19**	904,963	19
Total	**$ 5,338,351**	**100%**	$ 4,844,925	100%

4. Net Patient Service Revenue and Patient Accounts Receivable (continued)

The System has entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment to the System under these agreements includes prospectively determined rates per discharge, discounts from established charges, and negotiated daily rates. Inpatient acute care services and outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to a patient diagnosis-related group classification system that is based on clinical, diagnostic, and other factors. Inpatient and outpatient services rendered to Medicaid program beneficiaries are paid under cost reimbursement methodologies, prospectively determined rates per discharge, and prospectively determined or negotiated rates.

Revenue under certain third-party payor agreements is subject to audit, retroactive adjustments, and significant regulatory actions. Provisions for third-party payor settlements and adjustments are estimated and recorded in the period the related services are rendered and adjusted in future periods as final settlements are determined. At June 30, 2018 and 2017, the System has estimated third party settlements, net, of $42,928,000 and $62,782,000, respectively, recorded in accounts payable and accrued expenses in the consolidated financial statements. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is at least a possibility that recorded estimates will change by a material amount in the near term. For fiscal years 2018 and 2017, revenue increased $12,498,000 and $24,128,000, respectively, related to changes in estimates for cost report reopenings, appeals, and tentative and final cost report settlements on filed cost reports, of which some are still subject to audit, additional reopening, and/or appeal.

The System also receives payments through state supplemental payment programs, which includes Disproportionate Share (DSH) payments in multiple states, 1115(b) Waiver Program (Waiver Program) payments in the state of Texas, and Network Access Improvement Program (NAIP) payments in the state of Texas.

Federal law permits state Medicaid programs to make DSH payments to hospitals that serve a disproportionately large number of Medicaid and low-income patients. These funds are not tied to specific services for Medicaid-eligible patients. The federal government distributes federal Medicaid DSH funds to each state based on a statutory formula. The states then distribute the DSH funding among qualifying hospitals. States have broad discretion to define which hospitals qualify for Medicaid DSH payments and the amount of such payments. The System recorded $131,539,000 and $137,032,000 in net patient service revenue during fiscal years 2018 and 2017, respectively, related to the DSH program.

4. Net Patient Service Revenue and Patient Accounts Receivable (continued)

In December 2011, the Centers for Medicare and Medicaid Services (CMS) approved the Waiver Program submitted by the Texas Health and Human Services Commission (HHSC). The Waiver Program provides payments to hospitals through two pools: Uncompensated Care Pool (UC) and the Delivery System Reform Incentive Pool (DSRIP). Both pools replace the former Upper Payment Limit program in Texas. Payments under the Waiver Program are determined in each demonstration year, which aligns with the federal fiscal year. The Waiver Program was scheduled to expire on September 30, 2016; however, CMS approved a 15-month extension that ended December 31, 2017. On December 21, 2017, CMS approved a five-year renewal of the Waiver Program that expires September 30, 2022. September 30, 2017 marked the completion of the sixth demonstration year.

CMS extended the DSRIP funding pool for four years with the dollar amount of the pool declining each year beginning in the 9th demonstration year until it reaches $0 in the 11th demonstration year. Additionally, on January 19, 2018, CMS approved the DSRIP protocols, which cover the requirements for participation in DSRIP for demonstration years seven and eight. The System participates in 13 measure bundles as outlined in the protocols. The UC funding pool was extended for the full five-year period, with the level of funding subject to special terms and conditions. The UC funding pool disbursement methodology is being revised as part of the extension; however, the disbursement methodology will remain unchanged for demonstrations years seven and eight.

HHSC provides all Texas hospitals the DSH and UC tools for each demonstration year, which are used to determine qualification for payment under the programs. The 2017 tools have been finalized by HHSC and were used by HHSC in modeling both DSH and UC payments for the sixth demonstration year ended September 30, 2017. Additionally, the 2018 DSH and UC tools have been completed and will be used in finalizing DSH and UC payments for the seventh demonstration year that ends September 30, 2018.

The System recorded $318,917,000 and $250,947,000 in net patient service revenue during fiscal years 2018 and 2017, respectively, related to the Waiver Program. Given the complexity of the ultimate determination of payment due to the System under the Waiver Program, amounts recorded are based on estimates made by management with the assistance of various consultants. As a result, it is at least a possibility that recorded amounts may change by a material amount at the completion of each demonstration year. To this, of the amount recorded in fiscal year 2018, approximately $85,202,000 is related to prior demonstration years six and prior, and was recognized as amounts earned under the Waiver Program were determined and/or finalized.

4. Net Patient Service Revenue and Patient Accounts Receivable (continued)

In 2017, the System began participating in the NAIP, which is a joint federal and state of Texas Medicaid program, administered by CMS and HHSC, for Medicaid members enrolled in a managed care organization. NAIP was designed to further the state of Texas' goal of increasing the availability and effectiveness of primary care for Medicaid beneficiaries by incentivizing health-related institutions and public hospitals to provide quality, well-coordinated, continuous care. In fiscal years 2018 and 2017, the System recorded net patient service revenue of $15,431,000 and $13,708,000, respectively, related to the NAIP program.

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

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

4. Net Patient Service Revenue and Patient Accounts Receivable (continued)

Patient Accounts Receivable, Net of the Allowance for Doubtful Accounts

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

	2018	**2017**
Medicare	**18%**	18%
Medicaid	**3**	3
Managed care organizations	**48**	49
Commercial insurance	**4**	4
Self-pay	**11**	9
Others	**16**	17
	100%	100%

The provision for bad debts is determined considering historical experience, trends in health care coverage, and other collection indicators. A summary of the activity in the System's allowance for doubtful accounts is as follows (in thousands):

	Balance at Beginning of Year	**Provision for Bad Debts**	**Accounts Written Off, Net of Recoveries**	**Balance at End of Year**
Fiscal year ended June 30, 2018	**$ 310,089**	**$ 540,390**	**$ (423,747)**	**$ 426,732**
Fiscal year ended June 30, 2017	171,926	459,803	(321,640)	310,089

5. Cash and Investments

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

	2018	2017
Cash and cash equivalents	**$ 551,184**	$ 710,707
Certificates of deposit	**55,238**	30,304
Domestic equities	**98,665**	79,165
International equities	**24,180**	20,873
Fixed-income securities	**201,689**	118,663
U.S. government securities	**315,156**	270,565
Mutual funds and exchange-traded funds:		
Domestic equity funds	**58,383**	49,599
International equity funds	**72,578**	36,847
Fixed-income funds	**154,521**	161,610
Risk parity, blended and other funds	**43,088**	16,016
Equity in managed funds:		
Fixed-income funds	**135,084**	165,472
Hedge funds	**171,911**	213,112
Private equity, real estate, and other	**24,632**	10,642
	$ 1,906,309	$ 1,883,575

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

Fixed Income

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

5. Cash and Investments (continued)

Equities

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

Mutual Funds and Exchange-Traded Funds

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

Equity Investments in Managed Funds

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

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

5. Cash and Investments (continued)

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

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

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

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

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

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

At June 30, 2018, the System had commitments to fund equity investments in private equity funds totaling $13,565,000, excluding commitments to fund equity investments in private equity funds held by the CHRISTUS Cash Balance Plan (see Note 11).

5. Cash and Investments (continued)

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

	2018	2017
Assets whose use is limited or restricted, required for current bond indenture and self-insurance liabilities	**$ 64,869**	$ 58,831
Other investments, internally designated for capital expansion and other purposes	**457,868**	313,468
Under bond indenture agreement – held by trustee	**60,629**	59,332
Under liability retention and self-insurance funding arrangement – held by trustee	**19,363**	19,129
Under Emerald Assurance funding arrangements	**130,451**	222,633
Restricted cash and investments	**83,636**	95,363
Total assets whose use is limited or restricted	**$ 816,816**	$ 768,756

Restricted cash and investments relate primarily to investments required to be maintained in perpetuity under the System's endowments, or to cash and investments restricted by donors for the acquisition of capital assets. Investment returns and gains for assets limited as to use, cash equivalents, and other unrestricted investments consisted of the following for the fiscal years ended June 30 (in thousands):

	2018	2017
Operating interest and dividend income	**$ 11,742**	$ 9,932
Operating gain, realized and unrealized	**2,556**	4,292
Equity investment gain on managed funds	**13,693**	3,264
Total operating investment income	**27,991**	17,488
Non-operating interest and dividend income	**12,698**	10,312
Non-operating gain, realized and unrealized	**13,559**	35,875
Equity investment gain on managed funds	**7,051**	10,327
Net swap agreement activity	**19,442**	38,874
Total nonoperating investment gain	**52,750**	95,388
Total investment gain	**$ 80,741**	$ 112,876

6. Fair Value Measurements

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

- Level 1 – Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities at the reporting date.
- Level 2 – Inputs to the valuation methodology other than quoted market prices included in Level 1 that are observable for the asset or liability. Level 2 pricing inputs include quoted prices for similar assets and liabilities in active markets and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
- Level 3 – Inputs that are generally unobservable and typically reflect management's estimate of assumptions that market participants would use in pricing the asset or liability.

A financial instrument's categorization within the valuation hierarchy is based on the lowest level of input that is significant to the fair value measurement. There were no significant transfers between levels during the fiscal years ended June 30, 2018 and 2017.

6. Fair Value Measurements (continued)

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

	2018			
	Level 1	Level 2	Level 3	Total
Assets				
Investments:				
Cash and cash equivalents	$ 551,184	$ –	$ –	$ 551,184
Certificates of deposit	–	55,238	–	55,238
Domestic equities	98,665	–	–	98,665
International equities	24,180	–	–	24,180
Fixed-income securities	–	201,689	–	201,689
U.S. government securities	–	315,156	–	315,156
Mutual and exchange-traded funds:				
Domestic equity funds	48,380	–	–	48,380
International equity funds	72,578	–	–	72,578
Fixed-income funds	76,304	–	–	76,304
Risk parity, blended and other funds	43,088	–	–	43,088
	$ 914,379	$ 572,083	$ –	$ 1,486,462
Investments measured at net asset value or equivalent:				
Equity funds				10,003
Fixed-income funds				115,485
Hedge funds				55,490
Private equity, real estate and other funds				1,847
Total assets at fair value				$ 1,669,287
Liabilities				
Interest rate swap agreements	$ –	$ 86,120	$ –	$ 86,120
Total liabilities at fair value	$ –	$ 86,120	$ –	$ 86,120

6. Fair Value Measurements (continued)

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

6. Fair Value Measurements (continued)

The tables above include equity investments in managed funds held within the System's foundations and captive insurer. Remaining equity investments in managed funds held by other System entities of $237,022,000 and $294,023,000 at June 30, 2018 and 2017, respectively, are not included in this table since they are accounted for using the equity method of accounting.

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

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

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

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

At June 30, 2018 and 2017, the System's financial instruments included cash and cash equivalents, accounts receivable, assets limited as to use, accounts payable and accrued expenses, estimated third-party payor settlements, and long-term debt. The carrying amounts reported in the consolidated balance sheets for these financial instruments, except for long-term debt, approximate their fair values due to their short-term nature.

The System's fixed-rate debt is enhanced with bond insurance. The estimated fair value of the fixed-rate debt, if it were not enhanced by insurance, is $458,546,000 compared to its carrying value of $451,615,000 at June 30, 2018. This fair value is based on a combination of quoted market prices for identical securities when available, a Level 1 input, and quoted market prices for similarly rated health care revenue bond issues, a Level 2 input.

6. Fair Value Measurements (continued)

At June 30, 2018, the System has several issuances of variable-rate demand bonds outstanding totaling $225,885,000. The System's continued participation in these debt programs depends on its ability to extend or replace the existing credit facilities supporting the respective standby purchase agreements. If these credit facilities are not available, the System will likely refund these outstanding series with available funds or funds derived from fixed-rate series proceeds. It is not practicable to estimate the fair value of the variable-rate demand bonds separate from the value supported by the credit facilities.

7. Property and Equipment

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

	2018	2017
Land	**$ 217,263**	$ 197,080
Land improvements	**87,826**	83,512
Buildings and fixed equipment	**3,034,139**	2,903,194
Major movable equipment	**1,769,006**	1,701,737
Accumulated depreciation	**(2,828,302)**	(2,735,811)
	2,279,932	2,149,712
Construction-in-progress (estimated cost to complete is $309,000 and $439,000 at June 30, 2018 and 2017, respectively)	**302,887**	208,964
Total	**$ 2,582,819**	$ 2,358,676

Depreciation expense for the System for fiscal years 2018 and 2017 totaled $231,150,000 and $211,440,000, respectively. The total includes impairment losses of $0 and $10,756,000 in fiscal years 2018 and 2017, respectively.

Assets capitalized under capital leases as reflected in the accompanying consolidated balance sheets included $94,482,000 of buildings and fixed equipment and $49,855,000 of major moveable equipment as of June 30, 2018, and $77,732,000 of buildings and fixed equipment and $49,406,000 of major moveable equipment as of June 30, 2017. The accumulated depreciation related to assets under capital leases was $65,483,000 and $57,199,000 as of June 30, 2018 and 2017, respectively. Depreciation of assets under capital leases is included in depreciation expense.

8. Investments in Unconsolidated Organizations

The System has investments in unconsolidated organizations of $200,059,000 and $150,823,000 at June 30, 2018 and 2017, respectively. Differences between the carrying amounts of the System's investments and the underlying equity in the net assets of the investees total $52,962,000 and $56,044,000 at June 30, 2018 and 2017, respectively, which relates primarily to equity method goodwill. The following table summarizes the investments in unconsolidated organizations as of June 30, 2018 and 2017 (in thousands):

Investee	Accounting Policy	2018	2017
U.C. CHRISTUS Salud SpA	Equity method	**$ 135,108**	$ 95,392
Sinergia Global en Salud SAS	Equity method	**4,993**	15,414
Coomeva Medicina Prepagada	Cost method	**11,457**	11,457
Southwest Post-Acute Care Partnership	Equity method	**17,133**	–
HealthSouth Rehabilitation Hospital	Equity method	**11,674**	7,803
CS/USP Surgery Centers, L.P.	Equity method	**6,752**	7,064
Other	Equity method	**12,942**	13,693
Total		**$ 200,059**	$ 150,823

U.C. CHRISTUS Salud SpA (Formerly Salud U.C. SpA and Inversiones San Carlos, SpA)

In fiscal 2014, CHRISTUS entered into various transactions to obtain non-controlling interests in certain health care operations in Chile. As a result of these transactions, CHRISTUS obtained a 40% ownership interest in Salud U.C. SpA (Salud U.C.) and a 50% ownership interest in Inversiones San Carlos, SpA (San Carlos), which are operated and controlled by Pontifica Universidad Catolica de Chile (PUC). In May 2016, CHRISTUS and PUC executed new operating agreements that described a series of transactions under which the operations of these entities would be reorganized into one legal entity, owned 50% by CHRISTUS and 50% by PUC. In June 2018, these transactions were completed, and the operations of Salud U.C. and San

8. Investments in Unconsolidated Organizations (continued)

Carlos were reorganized into U.C. CHRISTUS Salud SpA (CHRISTUS Salud). Note 17 has additional discussion of the System's international operations.

During 2018 and 2017, CHRISTUS made additional capital contributions to CHRISTUS Salud and its predecessor entities of $14,560,000 and $17,398,000, respectively. In addition, as contemplated under the operating agreements, certain loans from CHRISTUS to San Carlos, which together with accrued interest totaled $25,526,000, were converted to capital contributions in 2018. The System's share of losses for the fiscal years ended June 30, 2018 and 2017, was $(370,000) and $(890,000), respectively. CHRISTUS' recorded investment, accounted for under the equity method, was $135,108,000 and $95,392,000 at June 30, 2018 and 2017, respectively.

Sinergia Global en Salud SAS and Coomeva Medicina Prepagada

Effective June 14, 2016, CHRISTUS signed definitive agreements with Cooperativa Medica del Valle y de Profesionales de Colombia (Coomeva) in Colombia to invest in certain of Coomeva's health care operations. In September 2016, CHRISTUS closed on various transactions outlined in the definitive agreements and paid $10,741,000 to obtain a 21% non-controlling ownership interest in Sinergia Global en Salud SAS (Sinergia) and $11,457,000 to obtain a 10% non-controlling ownership interest in Coomeva Medicina Prepagada (MP). In September 2017 and March 2017, CHRISTUS paid an additional $9,231,000 and $5,087,000, respectively, to increase its ownership interest in Sinergia to 50%. During 2018, CHRISTUS and Coomeva also contributed an additional $2,075,000 each as part of a capital call that did not affect ownership percentages. Note 17 has additional discussion of the System's international operations.

The System's investment in Sinergia is accounted for under the equity method of accounting because CHRISTUS can exercise significant influence over Sinergia's operations. The System's investment in MP is accounted for under the cost method because CHRISTUS does not exercise significant influence over MP's operations. The System's investment in Sinergia was $4,993,000 and $15,414,000 at June 30, 2018 and 2017, respectively. The System recorded its share of losses from the operations of Sinergia during the fiscal years ended June 30, 2018 and 2017, of $(21,727,000) and $(413,000), respectively. Dividends of $1,145,000 and $257,000 were declared by MP and recorded as other revenue during the fiscal years ended June 30, 2018 and 2017, respectively.

8. Investments in Unconsolidated Organizations (continued)

Southwest Post-Acute Care Partnership

Effective September 1, 2017, CHRISTUS Continuing Care contributed substantially all of the assets of its long-term acute care hospitals (LTAC) and home care business to a newly formed entity, Southwest Post-Acute Care Partnership, LLC (Southwest Partnership), in exchange for cash proceeds and a 40% non-controlling interest in Southwest Partnership. The System recorded a gain on the transaction of $36,340,000, equal to the fair value of the cash proceeds and non-controlling interest in Southwest Partnership, less the carrying value of the contributed assets, and which is recorded as other revenue including gain on contribution to joint ventures in the accompanying consolidated financial statements. The System's recorded investment was $17,133,000 at June 30, 2018. The System recorded its share of losses from operations during the fiscal year ended June 30, 2018 of $(1,669,000).

HealthSouth Rehabilitation Hospital

CHRISTUS Trinity Mother Frances Health System owns 50% of HealthSouth Rehabilitation Hospital – Tyler d/b/a/ Trinity Mother Frances Rehabilitation Hospital (HealthSouth). Because CHRISTUS can exercise significant influence over the operations of HealthSouth, but does not control HealthSouth, this investment is accounted for using the equity method of accounting. The System's recorded investment was $11,674,000 and $7,803,000 at June 30, 2018 and 2017, respectively. The System recorded its share of income from operations during the fiscal years ended June 30, 2018 and 2017, of $5,387,000 and $3,627,000, respectively.

CS/USP Surgery Centers, L.P.

CHRISTUS Spohn Health System Corporation has a 50% ownership interest in a Texas limited liability partnership with United Surgical Partners International, Inc. for the purpose of owning and operating ambulatory surgery centers in Corpus Christi, Texas. The venture consists of two surgery centers near the campus of Spohn Shoreline, Corpus Christi Outpatient Surgery and SurgiCare, and one endoscopy center. CHRISTUS' recorded investment, accounted for under the equity method, was $6,752,000 and $7,064,000 at June 30, 2018 and 2017, respectively. The System recorded its share of income from operations during the fiscal years ended June 30, 2018 and 2017, of $1,085,000 and $1,080,000, respectively.

CHRISTUS and its affiliates hold immaterial investments in other unconsolidated subsidiaries. No other single investment balance exceeded $5,000,000 at both June 30, 2018 and 2017.

9. Long-Term Debt

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

	2018	2017
Obligations issued under the CHRISTUS Health Master Trust Indenture:		
Revenue bonds, in variable-rate demand mode, with weighted average interest rates of 1.15% and 0.69% in fiscal years 2018 and 2017, respectively, due in annual installments through July 1, 2047 (Series 2008C and 2009B)	**$ 225,885**	$ 225,885
Revenue bonds, in auction mode, with weighted average interest rates of 1.39% and 0.87% in fiscal years 2018 and 2017, respectively, due in annual installments through July 1, 2031	**154,700**	156,575
Revenue bonds, in fixed-rate mode, bearing interest from 4.50% to 6.50%, due in annual installments through July 1, 2035	**313,450**	338,210
Direct-placement notes due in annual installments through July 1, 2041	**109,842**	117,199
Tax-exempt bank note due in annual installments through July 1, 2039	**57,105**	57,105
Obligations issued under The Good Shepherd Hospital, Inc. Master Trust Indenture:		
Revenue bonds, in fixed-rate mode, bearing interest from 3.82% to 5.25%, due in annual installments through July 1, 2042	**58,970**	61,810
Direct-placement note due in annual installments through October 1, 2029	**69,200**	69,200
Bank line of credit	**150,000**	–
Other notes and capital lease obligations	**178,998**	160,082
	1,318,150	1,186,066
(Discounts) and premiums, net, on long-term debt	**(12,011)**	(15,345)
Unamortized deferred financing costs	**(7,905)**	(8,716)
	1,298,234	1,162,005
Less current portion	**(51,359)**	(44,880)
Total	**$ 1,246,875**	$ 1,117,125

9. Long-Term Debt (continued)

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

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

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

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

9. Long-Term Debt (continued)

require that certain funds be established with a trustee, and that members of the GSH Obligated Group comply with certain covenants, including maintaining sufficient debt service coverage, restrictions on incurrence of additional debt, and restrictions on the disposition of assets or transfers of assets out of the GSH Obligated Group. In connection with the acquisition of CHRISTUS Good Shepherd Health System in February 2017, Good Shepherd Health System obtained a waiver of certain covenants and requirements under the GSH MTI, including the rate covenant through September 30, 2018 and the timely filing of financial statements for the fiscal year ending September 30, 2016. In July 2018, a waiver was obtained under the GSH MTI for the requirement for filing separately audited financial statements for fiscal years 2018 through 2022. The CHRISTUS audited financial statements with consolidating schedules was approved to satisfy this requirement.

CHRISTUS has letter of credit bank agreements on Series 2008C and 2009B variable-rate demand bonds. The Series 2008C-1 bonds have an outstanding amount of $41,435,000 and are supported by a line of credit provided by Sumitomo Mitsui Banking Corporation, acting through its New York branch, that expires on September 21, 2020. The 2008C-2 bonds have an outstanding amount of $38,305,000 and are supported by a letter of credit provided by The Bank of New York Mellon that expires on June 23, 2021. The 2008C-3 bonds have an outstanding amount of $43,900,000, and the 2008C-4 bonds have an outstanding amount of $38,440,000. The 2008C-3 and 2008C-4 bonds are supported by a letter of credit provided by Bank of Montreal, acting through its Chicago branch, that expires on April 25, 2020. The Series 2009B variable-rate demand bonds have an outstanding amount of $63,805,000 and are supported by a letter of credit provided by The Bank of New York Mellon that expires on January 31, 2022.

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

Other notes and capital lease obligations were $328,998,000 and $160,082,000 as of June 30, 2018 and 2017, respectively. Other notes account for $204,412,000 and $47,952,000 of that balance as of June 30, 2018 and 2017, respectively. In fiscal 2018, the System entered into a new line of credit with Sumitomo Mitsui Banking Corporation – New York Operations for $150,000,000. The line of credit carries a variable interest rate equal to the one-month LIBOR plus 0.625%, and terminates

9. Long-Term Debt (continued)

on October 30, 2019. The remaining other notes include various notes issued primarily to purchase equipment. Capital lease obligations account for $124,586,000 and $112,130,000 of that balance as of June 30, 2018 and 2017, respectively, and include various building and equipment leases.

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

2019	$ 51,359
2020	223,301
2021	54,525
2022	50,605
2023	49,568
Thereafter	888,792
Total debt	$ 1,318,150

10. Derivative Financial Instruments

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

Market risk is the adverse effect on the value of a financial instrument that results from a change in interest rates. The market risk associated with interest rate changes is managed by establishing and monitoring parameters that limit the types and degrees of market risk that may be undertaken. Management also mitigates risk through periodic reviews of their derivative positions in the context of their blended cost of capital. As of June 2018 and 2017, CHRISTUS has interest rate swap agreements to manage interest rate risk exposure, not designated as hedging instruments, with a total notional amount of $912,035,000 and $921,035,000, respectively.

10. Derivative Financial Instruments (continued)

The following tables summarize the fair value at June 30, 2018 and 2017, and the income (loss) recorded related to the System's derivative instruments as of and for the fiscal years ended June 30, 2018 and 2017 (in thousands):

					Fair Value		Change in Fair Value		(Paid) Received	
Counterparty	**Description**	**Termination Date**	**Agreements**	**Notional Amount**	**June 30, 2018**	**June 30, 2017**	**June 30, 2018**	**June 30, 2017**	**June 30, 2018**	**June 30, 2017**
Merrill Lynch	Var. basis	2021-2023	6	$ 470,000	**$ 2,818**	$ (420)	**$ 3,238**	$ 960	**$ 217**	$ (581)
Wells Fargo	Fixed payer	2031	1	162,775/171,775	**(13,363)**	(20,671)	**7,308**	11,479	**(3,569)**	(4,664)
Citigroup*	Fixed payor	2047	2	166,100	**(45,473)**	(56,818)	**11,345**	23,740	**(4,095)**	(4,924)
Citigroup*	Fixed payor	2047	1	113,160	**(30,554)**	(38,251)	**7,697**	16,181	**(2,751)**	(3,316)
			10	$ 912,035/921,035	**$ (86,572)**	$(116,160)	**$ 29,588**	$ 52,360	**$(10,198)**	$(13,485)
Other Derivative Contracts										
BBVA	Currency Put/Call	2018	2	15,000//25,000	**452**	–	**52**	–	**–**	–
Total			2	$ 927,035/946,035	**$ (86,120)**	$ (116,160)	**$ 29,640**	$ 52,360	**$ (10,198)**	$ (13,485)

*Insured by MBIA

CHRISTUS is required to post collateral for negative valuations on each of its swaps according to the terms of (1) the swap insurance agreements, where applicable and (2) the agreement with each counterparty. CHRISTUS has complied with this requirement. At June 30, 2018 and 2017, no collateral was posted. The System does not anticipate nonperformance by its counterparties.

The fair value of these derivative instruments was a liability of $86,120,000 and $116,160,000 at June 30, 2018 and 2017, respectively. The change in value of $29,640,000 and $52,360,000 for the fiscal years ended June 30, 2018 and 2017, respectively, is combined with the payments, net of receipts, made under the agreements of $10,198,000 and $13,485,000 for the fiscal years ended June 30, 2018 and 2017, respectively. This total is included in nonoperating investment gain in the consolidated statements of operations and changes in net assets.

11. Employee Benefit Plans

Defined Benefit Plans

Cash Balance Plan

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

11. Employee Benefit Plans (continued)

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

Mother Frances Hospital Defined Benefit Pension Plan

The System administers the Mother Frances Hospital Defined Benefit Pension Plan (TMF Plan), which covers all employees who meet the eligibility requirements. The plan was frozen as of December 31, 2009.

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

	Cash Balance Plan		TMF Plan	
	2018	**2017**	**2018**	**2017**
Service cost	**$ 16,293**	$ 16,648	**$ –**	$ –
Interest cost	**29,041**	24,551	**6,446**	7,190
Expected return on assets	**(48,974)**	(47,128)	**(7,391)**	(7,663)
Amortization of prior service credit	**(11,884)**	(11,884)	**–**	–
Recognized net actuarial loss (gain)	**19,463**	22,433	**(12)**	–
Settlement credit	**–**	–	**(3,559)**	–
Net periodic benefit cost (credit)	**$ 3,939**	$ 4,620	**$ (4,516)**	$ (473)

CHRISTUS uses a full yield curve "spot rate" approach that applies the specific spot rates along the yield curve to the plans' projected cash flows in order to estimate the service and interest cost components of net periodic benefit cost (credit).

During fiscal year 2018, the TMF Plan activity includes a settlement credit as a result of lump sum windows offered to vested, terminated participants. The lump sum was offered in two different windows, which resulted in two separate settlement credits and re-measurements of the benefit obligation.

11. Employee Benefit Plans (continued)

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

	Cash Balance Plan		TMF Plan	
	2018	**2017**	**2018**	**2017**
Changes in benefit obligation				
Benefit obligation – beginning of year	**$ 946,634**	$ 927,737	**$ 224,615**	$ 229,445
Service cost	**16,293**	16,648	**–**	–
Interest cost	**29,041**	24,551	**6,446**	7,190
Actuarial (gain) loss	**(6,253)**	22,719	**(18,534)**	(6,406)
Benefits paid	**(50,819)**	(45,021)	**(44,485)**	(5,614)
Benefit obligation – end of year	**$ 934,896**	$ 946,634	**$ 168,042**	$ 224,615

	Cash Balance Plan		TMF Plan	
	2018	**2017**	**2018**	**2017**
Changes in plan assets				
Fair value of plan assets – beginning of year	**$ 839,357**	$ 804,569	**$ 163,028**	$ 144,774
Actual return on plan assets	**60,248**	66,309	**8,453**	14,868
Employer contributions	**9,600**	13,500	**9,000**	9,000
Benefits paid	**(50,819)**	(45,021)	**(44,485)**	(5,614)
Fair value of plan assets – end of year	**$ 858,386**	$ 839,357	**$ 135,996**	$ 163,028
Funded status	**$ (76,510)**	$ (107,277)	**$ (32,046)**	$ (61,587)
Amounts recognized in unrestricted net assets:				
Unrecognized net actuarial loss (gain)	**$ 193,918**	$ 230,908	**$ (23,957)**	$ (7,933)
Unrecognized prior service credit	**(11,910)**	(23,793)	**–**	–
Total recognized in unrestricted net assets	**$ 182,008**	$ 207,115	**$ (23,957)**	$ (7,933)

Amounts recognized in unrestricted net assets expected to be recognized in net periodic benefit cost for the Defined Benefit Plans during fiscal 2019 are $2,240,000.

11. Employee Benefit Plans (continued)

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

	Cash Balance Plan		TMF Plan	
	2018	**2017**	**2018**	**2017**
Net actuarial (gain) loss	**$ (17,527)**	$ 3,537	**$ (19,596)**	$ (13,611)
Amortization of net actuarial (loss) gain	**(19,463)**	(22,433)	**12**	–
Amortization of prior service credit	**11,884**	11,884	**–**	–
Settlement credit	**–**	–	**3,559**	–
Total changes recognized in unrestricted net assets	**$ (25,106)**	$ (7,012)	**$ (16,025)**	$ (13,611)

As of June 30, 2018 and 2017, the Defined Benefit Plans had accumulated benefit obligations of $1,100,848,000 and $1,167,877,000, respectively. Assumptions used to determine benefit obligations and net periodic benefit cost for the fiscal years were as follows:

	Cash Balance Plan		TMF Plan	
	2018	**2017**	**2018**	**2017**
Benefit obligations:				
Discount rate	**4.17%**	3.78%	**4.25%**	3.97%
Rate of compensation increase	**3.71**	3.71	**N/A**	N/A
Net periodic benefit cost:				
Discount rate[1]	**3.78**	3.54	**3.97[1]** **3.89[1]** **4.13[1]**	3.85
Expected long-term return on plan assets	**6.00**	6.00	**5.25**	5.25
Rate of compensation increase	**3.71**	3.71	**N/A**	N/A

[1] The discount rate for the TMF Plan for fiscal 2018 was reset at the time of the re-measurements of the benefit obligation resulting from the settlements associated with the lump sum option offered to terminated, vested participants.

11. Employee Benefit Plans (continued)

Investment Policy and Asset Allocations

CHRISTUS Health Cash Balance Plan

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

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

11. Employee Benefit Plans (continued)

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

	2018	2017
Cash and cash equivalents	**$ 106,170**	$ 94,427
Domestic equities	**44,701**	44,209
International equities	**25,570**	22,346
Mutual funds and exchange-traded funds:		
Domestic equity funds	**35,150**	35,341
International equity funds	**54,160**	45,414
Fixed-income funds	**64,235**	63,907
Equity investments in managed funds:		
Fixed-income funds	**320,048**	312,916
Hedge funds	**57,230**	77,892
Private equity, real estate, and other	**150,809**	142,586
Other	**313**	319
Total	**$ 858,386**	$ 839,357

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

	2018	2017
Allocation of plan assets by asset category:		
Cash and cash equivalents	**0%**	0%
Equity securities and equity funds	**15**	15
Fixed-income securities and fixed-income funds	**30**	30
Equity investments in managed funds (*Note 5*)	**55**	55
Total	**100%**	100%

11. Employee Benefit Plans (continued)

The value of the plan assets measured at fair value on a recurring basis was determined using the valuation inputs described in Note 6 and categorized at June 30, 2018, as follows (in thousands):

	Level 1	Level 2	Level 3	Total
Assets				
Investments:				
Cash and cash equivalents	**$ 106,170**	**$ –**	**$ –**	**$ 106,170**
Domestic equities	**44,701**	**–**	**–**	**44,701**
International equities	**25,570**	**–**	**–**	**25,570**
Mutual funds and exchange-traded funds:				
Domestic equity funds	**35,150**	**–**	**–**	**35,150**
International equity funds	**54,160**	**–**	**–**	**54,160**
Fixed-income funds	**64,235**	**–**	**–**	**64,235**
Other	**313**	**–**	**–**	**313**
	$ 330,299	**–**	**–**	**$ 330,299**
Investments measured at net asset value or equivalent:				
Fixed-income funds				**320,048**
Hedge funds				**57,230**
Private equity, real estate, and other funds				**150,809**
Total assets at fair value				**$ 858,386**

11. Employee Benefit Plans (continued)

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

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

The cash balance plan has $76,177,000 of funding commitments to purchase private equity, real estate and other funds as of June 30, 2018.

TMF Plan

Until March 1, 2018, assets of the TMF Plan were held in the Texas Hospital Association Retirement Trust (THART) for member hospitals, which invests plan assets for the plans of its participating hospitals. The investment objectives for the trust are to provide returns that improve the funded status of the participating hospital's plans over time and reduce pension costs and to receive favorable performance from the pension fund's active managers in exchange for the fees paid to the investment management fund. Investments in the THART were measured at fair value

11. Employee Benefit Plans (continued)

using net asset value per share or its equivalent as a practical expedient and have not been categorized within the fair value hierarchy as of June 30, 2017. Trustees of THART developed asset mix targets, which reflect the holdings of the TMF Plan and which consisted primarily of marketable debt and equity securities as of June 30, 2017.

On March 1, 2018, the assets of the TMF Plan were moved from THART to a new investment custodian. TMF Plan assets are now managed directly by CHRISTUS, and the method for establishing asset mix targets is consistent with that described above for the cash balance plan. The target asset mix is as follows as of June 30, 2018:

	Target
Equity securities	33%
Alternative investments	30
Fixed-income securities	35
Cash and cash equivalents	2
	100%

The value of the plan assets measured at fair value on a recurring basis was determined using the valuation inputs described in Note 6 and categorized at June 30, 2018, as follows (in thousands):

	Level 1	Level 2	Level 3	Total
Assets				
Investments:				
Cash and cash equivalents	$ 32,916	$ –	$ –	$ 32,916
Mutual funds and exchange-traded funds:				
Domestic equity funds	32,091	–	–	32,091
International equity funds	15,714	–	–	15,714
Fixed-income funds	51,258	–	–	51,258
	$ 131,979	–	–	$ 131,979
Investments measured at net asset value or equivalent:				
Hedge funds				4,017
Total assets at fair value				$ 135,996

11. Employee Benefit Plans (continued)

Contributions

In fiscal year 2019, CHRISTUS expects to contribute $16,000,000 to the Defined Benefit Plans based on asset values for the plan year beginning January 1, 2017. Contributions to the cash balance plan of $9,600,000 and $13,500,000 were made for plan years beginning January 1, 2018 and 2017, respectively, and contributions to the TMF Plan of $9,000,000 were made during fiscal years 2018 and 2017.

Benefit Payments

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

	Cash Balance Plan	TMF Plan
2019	$ 58,290	$ 6,989
2020	58,776	7,365
2021	59,530	7,750
2022	61,361	8,091
2023	64,084	8,386
Years 2024–28	314,107	45,637

Postretirement Health Care Benefits

Comprehensive medical benefits are provided to eligible active employees who, immediately upon retirement and attainment of the age of 55, will receive a pension under the CHRISTUS retirement plan. Postretirement benefits are also provided to former employees who are currently receiving pension benefits. The comprehensive medical program, which is self-insured, provides reimbursement benefits until the participant attains the age of 65. The program also covers dependents of retirees, in addition to former employees. Contributions are required. Retirees may choose one of two self-insured indemnity plan options. Effective February 1, 1999, the CHRISTUS postretirement benefit plan was curtailed prospectively. As of the effective date, new employees or employees who had not vested as of that date are not eligible for the postretirement health care benefits. Effective January 1, 2016, the plan was amended to limit new participants to associates over the age of 52, who otherwise meet the eligibility requirements and elect to retire

11. Employee Benefit Plans (continued)

prior to December 31, 2018. Coverage for new participants is in the form of a subsidy for each retiree and qualifying dependents. The liability associated with the postretirement plan will be reduced as employee participation decreases. Net benefit credit under the postretirement plan was $3,222,000 and $5,538,000 for the fiscal years ended June 30, 2018 and 2017. The net benefit obligation was $8,519,000 and $12,089,000 at June 30, 2018 and 2017, respectively, which is included in accrued other long-term obligations on the accompanying balance sheets. The postretirement plan is unfunded.

Other Defined Benefit Plans

In addition to the CHRISTUS Cash Balance Plan and the TMF Plan, CHRISTUS also participates in various defined benefit plans for executives that have been frozen or curtailed. The net benefit credit under these plans was $195,000 and $203,000 for the fiscal years ended June 30, 2018 and 2017, respectively. The net benefit obligation was $5,492,000 and $5,977,000 for the fiscal years ended June 30, 2018 and 2017, respectively. These plans are unfunded.

Defined Contribution Plans

403(b) Matched Savings Plans

The System has a defined contribution plan (the Matched Savings Plan) covering eligible CHRISTUS employees. Annual employee contributions are limited to 50% of compensation, up to Internal Revenue Service dollar limits. The System will match 50% of employee contributions, not to exceed 6% of annual compensation. Employer contributions vest to the employee over a five-year period. For the fiscal years ended June 30, 2018 and 2017, expenses attributable to the Matched Savings Plan amounted to $21,928,000 and $19,084,000, respectively.

CHRISTUS St. Vincent Regional Medical Center (St. Vincent) has two 403(b) defined contribution plans for bargaining and non-bargaining employees. St. Vincent contributes 4.00% of gross salaries for bargaining employees and 4.25% of gross salaries for non-bargaining employees, as defined by the plans' agreements. The employer contributions are remitted biweekly. For fiscal years 2018 and 2017, St. Vincent has incurred $5,165,000 and $4,463,000, respectively, in expenses related to the plans.

11. Employee Benefit Plans (continued)

Supplemental Executive Retirement Plan (DC SERP)

On January 1, 2014, CHRISTUS established the DC SERP to provide a select group of executives and management of CHRISTUS and its selected subsidiaries and/or affiliates with supplemental benefits held in a Rabbi trust until paid, primarily at the termination of the individual's service with CHRISTUS. The DC SERP also includes provisions for a deferred compensation plan. As of June 30, 2018 and 2017, the asset and corresponding liability balances recorded related to the DC SERP were $22,783,000 and $29,465,000, respectively. CHRISTUS incurred expense of $18,203,000 and $15,518,000 related to the DC SERP in fiscal years 2018 and 2017, respectively.

Other Supplemental Retirement Plans

In addition to DC SERP, CHRISTUS also has various supplemental executive retirement plans that have been frozen. The funds contributed by participants are held in a Rabbi trust until vesting requirements have been satisfied. The System has an asset recorded for the investments in the Rabbi trust with a corresponding liability. As of June 30, 2018 and 2017, the total asset and corresponding liability were $1,012,000 and $1,704,000, respectively.

12. Self-Funded Liabilities

The System self-funds and self-insures for primary professional and general liability, workers' compensation and Texas occupational injury, directors' and officers' liability, employment practices liability, property and employee medical benefits. A wholly owned, captive insurance company, Emerald Assurance Cayman Ltd. (Emerald), is used to fund primary professional and general liability, property, directors' and officers' liability, and employment practices liability. Policies written provide coverage for professional liability with primary limits in the amount of $10,000,000 per claim with no aggregate plus $10,000,000 excess per claim with an aggregate of $10,000,000 for the fiscal years 2018 and 2017. For general liability, policies written provide coverage with primary limits in the amount of $2,000,000 per claim for fiscal years 2018 and 2017. Additionally, the System internally sets aside funds for workers' compensation, Texas occupational injury program, and employee medical benefits based on actuarial analyses.

12. Self-Funded Liabilities (continued)

During fiscal year 2017, CHRISTUS Trinity Mother Frances Health System (TMF), which was acquired by the System on May 1, 2016, maintained a separate insurance program covering all coverages except directors' and officers' liability, employment practices liability, property insurance and occupational injury (workers' compensation program). TMF's directors' and officers' liability, employment practices liability and property insurance coverages were merged into the System program on May 1, 2016. TMF's occupational injury (workers' compensation program) was merged with the CHRISTUS program on January 1, 2017. TMF was self-insured for the first $3,000,000 of each medical malpractice claim and funded a health care liability trust for payment of malpractice losses and expenses. The estimated self-funded losses include expected claim payments, including settlement costs for reported claims and an actuarial determination of expected losses related to claims that have been incurred but not reported. TMF was also a Texas Certified Self-Insurer for workers' compensation and sets aside funds for workers' compensation and employee medical benefits for claims occurring up until January 1, 2017. Commercial insurance policies cover other risk exposures, including ambulance and auto liability; aviation liability; cyber liability; and excess professional, general and workers' compensation liability. Effective July 1, 2017, any claims for all TMF coverages except professional liability for physician employed by CHRISTUS Trinity Clinic were covered through the System risk finance program. The CHRISTUS Trinity Clinic employed physicians continue to be covered under the TMF health care liability trust.

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

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

13. Commitments and Contingencies

Operating Leases

The System leases various equipment and facilities under noncancelable operating leases expiring at various dates through May 20, 2045. Total rental expense in 2018 and 2017 for all operating leases was $75,703,000 and $71,373,000, respectively.

The System's leases have varying terms, which may include renewal or purchase options and escalation clauses that are factored into determining minimum lease payments. The following is a schedule by year of future minimum lease payments under operating leases as of June 30, 2018, that have initial or remaining lease terms in excess of one year (in thousands):

2019	$ 52,641
2020	40,470
2021	31,843
2022	26,359
2023	21,679
Thereafter	55,871
Total	$ 228,863

Financing Transaction

Certain real estate and medical office buildings acquired from Good Shepherd Health System (see Note 18) were part of a sale-leaseback transaction that is being accounted for as a financing transaction due to continuing involvement based on certain contingencies in the agreements, which precluded the de-recognition of the assets when the transaction closed. The terms of the lease agreements range from 10 to 15 years, and lease payments are allocated between interest and a reduction of the financing obligation based on the applicable interest rate. The System's financing obligation is recorded as a component of current and other noncurrent liabilities totaling $64,902,000 and $66,422,000 at June 30, 2018 and 2017, respectively. The System is depreciating the assets over their remaining useful lives in accordance with the System's policy, and the net book value of these assets is approximately $61,383,000 and $65,300,000 at June 30, 2018 and 2017, respectively. The System recognized interest expense of $4,710,000 and $2,004,000 pertaining to these agreements for the fiscal years ended June 30, 2018 and 2017, respectively.

13. Commitments and Contingencies (continued)

Capital Commitments

The System has committed to fund $700,000,000 in capital expenditures related to the acquisition of Trinity Mother Frances Health System in May 2016. The commitment is to be funded over a period of up to seven years from funds generated by the operations of Trinity Mother Frances Health System and other resources. The System reports the expenditures as of April 30 of each year to Covenant Corporation, an external organization established at the time of the purchase. As of April 30, 2018, the System had expended $282,479,000 toward the commitment.

Other Contingencies

From time to time, the System is subject to litigation in the ordinary course of operations. Management is not aware of any pending or threatened litigation that would have a material effect on the System's consolidated financial statements.

Health care is a highly regulated industry. The System has a compliance program and various internal policies and procedures that are designed to ensure compliance with applicable federal, state and local laws and regulations and reduce potential exposure to fines, penalties, repayment obligations and other sanctions for violations of such laws and regulations. As a result of the System's compliance, internal audit and other operational activities, from time to time the System identifies instances in which it has a repayment or self-disclosure obligation. In addition, the System may incur repayment obligations or be subject to penalties as a result of audits and investigations by governmental agencies and contractors or commercial payors.

Because the government's present regulatory and enforcement efforts are widespread across the health care industry and may vary from region to region, the impact of such activities on the System is difficult to predict with certainty. The dynamic regulatory environment, political climate, and the effectiveness of the System's compliance efforts are all factors that may affect the resolution of regulatory, enforcement and payor issues involving System entities. The System has implemented, and continually works to enhance, various policies and procedures to ensure compliance with applicable legal requirements. However, there can be no assurance that the System's compliance program or other measures will be able to reduce or eliminate all potential exposure for alleged or actual noncompliance with applicable laws and regulations or commercial payor requirements.

14. Functional Expenses

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

	2018	2017
Health care services	**$ 4,000,962**	$ 3,700,056
Physician services	**728,697**	423,818
General and administrative	**521,701**	717,315
Total	**$ 5,251,360**	$ 4,841,189

15. Temporarily and Permanently Restricted Net Assets

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

	2018	2017
Purchase of equipment/capital improvement	**$ 38,254**	$ 39,710
Indigent care	**285**	327
Health education	**3,793**	5,986
Health care services	**109,219**	91,000
Community outreach	**14,524**	12,803
Other	**16,695**	9,195
Total	**$ 182,770**	$ 159,021

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

	2018	2017
Investments to be held in perpetuity, the income from which is expendable to support health care services (reported as operating income)	**$ 9,486**	$ 9,428
Endowment requiring income to be added to original gift	**613**	615
Other	**7,506**	6,837
Total	**$ 17,605**	$ 16,880

16. Changes in Consolidated Unrestricted Net Assets

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

	Controlling Interest	Non-Controlling Interests	Total
Balance, July 1, 2016	$ 2,599,043	$ 152,802	$ 2,751,845
Revenues in excess of expenses	141,369	31,735	173,104
Distributions	–	(6,913)	(6,913)
Acquisition of non-controlling interest	(202)	(318)	(520)
Non-controlling interests from business combinations	–	20,784	20,784
Change in pension liabilities	20,688	–	20,688
Other activities	37,805	3,765	41,570
Balance, June 30, 2017	2,798,703	201,855	3,000,558
Revenues in excess of expenses	**142,009**	**32,401**	**174,410**
Distributions	**–**	**(9,388)**	**(9,388)**
Acquisition of non-controlling interest	**(10,327)**	**(774)**	**(11,101)**
Non-controlling interests from business combinations	**–**	**14,550**	**14,550**
Change in pension liabilities	**41,204**	**–**	**41,204**
Other activities	**(7,918)**	**(522)**	**(8,440)**
Balance, June 30, 2018	**$ 2,963,671**	**$ 238,122**	**$ 3,201,793**

17. International Operations

CHRISTUS Muguerza

At June 30, 2018, the System owns an 86.6% interest in CHRISTUS Muguerza, S.A. de C.V. (CHRISTUS Muguerza), headquartered in Monterrey, Mexico. CHRISTUS Muguerza is a private health care system and is subject to taxes in accordance with the regulations of the Republic of Mexico. The financial statements of CHRISTUS Muguerza are presented in accordance with U.S. GAAP and are included in the CHRISTUS consolidated financial statements. CHRISTUS Muguerza has net assets of $125,136,000 and $112,127,000 at June 30, 2018 and 2017, respectively.

17. International Operations (continued)

In November 2012, the System and certain non-controlling interest holders entered into a revised shareholders' agreement, whereby the non-controlling interest holders of CHRISTUS Muguerza have a series of put options through December 31, 2028. These options will require the System to acquire shares, subject to an annual cap of either $3,500,000 or $2,000,000 depending on the year, at a formula price as defined. At June 30, 2018 and 2017, respectively, the System had $5,788,000 and $5,507,000 recorded as unrestricted net assets attributable to non-controlling interest to reflect such obligation to the non-controlling interest holders in connection with the agreement.

By purchasing 1,532,607 shares put forth by the non-controlling shareholders in accordance with the agreement during 2018, the System increased its ownership interest in CHRISTUS Muguerza from 85.6% to 86.6% for cash consideration of $2,000,000. During the year ended June 30, 2017, the System acquired 560,511 shares from non-controlling shareholders for cash consideration of $524,000.

Chile Operations

In February 2013, CHRISTUS signed a memorandum of understanding (MOU) with PUC in Santiago, Chile, to enter into a joint venture agreement for the ownership, operation, and expansion of PUC's health network. PUC is owned by the Catholic Church and operates one of the largest health systems in Chile for medical care and teaching. In May 2016, CHRISTUS and PUC executed several agreements, including a shareholders' agreement and an integration agreement (the PUC Agreements), that modify and finalize the specific terms and legal structure of the joint venture arrangement originally contemplated in the MOU. The key terms and transactions that occurred under the MOU and the PUC Agreements are described in detail below.

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

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

17. International Operations (continued)

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

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

The PUC Agreements executed in May 2016 proposed a restructuring of both Inversiones U.C. and Clinica San Carlos and outlined the timing of when specific assets and additional capital contributions would be made, which would occur in three closings. The first closing took place on July 15, 2016, at which time CHRISTUS made additional investments of $14,560,000 in Clinica San Carlos and $2,838,000 in Inversiones U.C. The second closing took place on September 27, 2017, at which time CHRISTUS made an additional investment of $14,560,000 in Clinica San Carlos. The final closing took place on June 28, 2018, at which point PUC contributed the assets and liabilities of certain health care businesses to Clinica San Carlos. These net assets were valued at approximately the same amount as the CHRISTUS capital contributions from the first and second closings, thus preserving the 50/50 equity ownership in Clinica San Carlos. Also as part of the final closing, Inversiones U.C. and Clinica San Carlos were reorganized into one joint venture entity, CHRISTUS Salud, in which both CHRISTUS and PUC own an equal 50% share. Finally, as part of the final closing, outstanding loans from CHRISTUS Chile SpA, together with accrued interest in a total amount of $25,526,000, were converted into additional capital contributions.

Under the terms of the PUC Agreements, CHRISTUS is expected to make additional capital contributions to CHRISTUS Salud at various times over the five-year period subsequent to the final closing. The specific amounts of capital contributions may vary but are expected to be no less than $95,550,000. Contributions towards this amount of $33,659,000 were made subsequent to year-end in July 2018.

The investment in CHRISTUS Salud is treated as an equity method investment. Discussion of the investment and earnings is in Note 8.

17. International Operations (continued)

During fiscal years 2015 through 2018, and in accordance with planned transactions outlined in the MOU and PUC Agreements, Amatista Financing Company, Ltd (Amatista), a wholly owned subsidiary of CHRISTUS, executed various loan agreements with PUC (PUC Loans), a related party and as of June 30, 2018, has loaned PUC a total of $70,000,000 under the terms of those agreements. As part of the final closing, the first $30,000,000 in notes, together with accrued interest, were due back to CHRISTUS. Payment of the notes and accrued interest was received subsequent to year-end in July 2018.

The remaining notes carry an interest rate of 3.17% per annum. Of the remaining notes, $20,000,000 matures in August 2021, and $20,000,000 matures in March 2022. At June 30, 2018 and 2017, accrued interest related to the PUC Loans, inclusive of amounts paid in July 2018, was $4,508,000 and $3,411,000, respectively. The PUC Loans are reported within other noncurrent assets in the accompanying consolidated balance sheets.

Concurrently with the execution of the PUC Agreements, CHRISTUS and PUC executed management and license agreements, under which CHRISTUS provides management services and licenses its trade name and certain other intellectual property to PUC's primary hospital. CHRISTUS and Clinica San Carlos (now CHRISTUS Salud) also entered into management and license agreements under which CHRISTUS provides management services and licenses its trade name and certain other intellectual property to all of the joint venture operations. The initial term of these agreements is 25 years. CHRISTUS recorded other revenue related to the management and license fee agreements of $18,399,000 and $13,259,000 during the fiscal years ended June 30, 2018 and 2017, respectively.

Colombia Operations

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

17. International Operations (continued)

In addition to these investments, in September 2016 CHRISTUS executed a loan with Coomeva EPS, an affiliate of Coomeva, for $2,578,000. Coomeva EPS is a health insurance company that contracts with the Colombian government. The loan is convertible into equity securities of Coomeva EPS after 30 months and carries a put option that CHRISTUS can exercise upon the occurrence of certain triggering events prior to conversion.

As part of the definitive agreements, CHRISTUS also entered into management agreements with Coomeva affiliates and earns a management fee for services provided under those agreements. During the fiscal years ended June 30, 2018 and 2017, CHRISTUS recorded $3,155,000 and $3,642,000, respectively, in management fee revenue under these agreements, which is classified as other revenue in the accompanying financial statements.

18. Significant Events

Business Combinations

Lake Area Medical Center

Effective July 1, 2017, CHRISTUS closed on a transaction with Community Health Systems, Inc. (CHS), in which CHRISTUS paid approximately $30,000,000 plus working capital and other adjustments to acquire Lake Area Medical Center (LAMC), together with certain related businesses including physician clinic operations. LAMC is a full-service acute care hospital located in Lake Charles, Louisiana. The transaction was accounted for using the acquisition method of accounting.

18. Significant Events (continued)

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

Consideration transferred	$ 31,329
Fair values of assets acquired and liabilities assumed:	
Cash and investments	4
Patient accounts receivable, net	281
Other current assets	2,258
Property and equipment, net	30,982
Other noncurrent assets	594
Accounts payable, accrued and other current liabilities	(1,162)
Other liabilities	(1,483)
Total fair values of assets acquired and liabilities assumed	31,474
Inherent contribution	$ 145

CHRISTUS also incurred $220,000 in transaction costs associated with the LAMC acquisition, which were expensed as a reduction of the inherent contribution, reducing the net gain recognized to zero.

For the period from July 1, 2017 through June 30, 2018, total operating revenue and revenues in excess (deficit) of expenses attributable to LAMC were $68,412,000 and $(884,000), respectively.

Imperial Calcasieu Surgical Center

Effective August 1, 2017, CHRISTUS closed on a transaction with Imperial Calcasieu Surgery Center, LLC (ICSC), in which CHRISTUS paid $15,144,000 to acquire a 51% majority ownership in ICSC, an outpatient surgical center, and $4,896,000 to acquire land previously owned by ICSC. Acquisition costs related to this transaction, which were recorded as other expenses, were immaterial.

18. Significant Events (continued)

The purchase was allocated to the fair values of the assets acquired and liabilities assumed as of the acquisition date, with the remaining amount recorded as goodwill, as summarized in the table below (in thousands):

Consideration transferred:		
Cash consideration	$	15,144
Fair value of non-controlling interest		14,550
Total consideration transferred		29,694
Fair values of assets acquired and liabilities assumed:		
Cash		1,141
Other current assets and liabilities, net		612
Property and equipment		700
Other liabilities		(21)
Total fair values of assets acquired and liabilities assumed		2,432
Goodwill	$	27,262

For the period from August 1, 2017 through June 30, 2018, total operating revenue and revenues in excess (deficit) of expenses attributable to ICSC were $13,194,000 and $2,930,000, respectively.

Good Shepherd Health System

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

18. Significant Events (continued)

In accordance with ASC 958-805, *Not-for-Profit Entities,* CHRISTUS recognized an inherent contribution as the excess of the acquisition date fair values of the assets acquired and liabilities assumed over the consideration transferred. The preliminary fair values assigned at the time of the transaction in fiscal 2017 are summarized as follows:

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

Existing donor-imposed restrictions on the use of the net assets acquired were retained in purchase accounting. CHRISTUS also incurred $2,584,000 in transaction costs associated with the GSHS acquisition, which were expensed as a reduction of the inherent contribution, for a net unrestricted gain recognized within inherent contribution from business combinations of $70,756,000. In fiscal year 2018, purchase accounting was finalized, and an adjustment was made to the preliminary values assigned to certain liabilities, resulting in an additional $15,000,000 inherent contribution.

18. Significant Events (continued)

For the period from February 1, 2017 through June 30, 2017, total operating revenue and revenues in excess (deficit) of expenses attributable to GSHS were $142,214,000 and $(13,672,000), respectively. For the fiscal year ended June 30, 2018, total operating revenue and revenues in excess (deficit) of expenses attributable to GSHS were $363,236,000 and $34,096,000, respectively.

CHRISTUS Hopkins Health Alliance

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

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

18. Significant Events (continued)

For the period from July 12, 2016 through June 30, 2017, total operating revenue and revenues in excess (deficit) of expenses attributable to CHHA were $51,913,000 and $(12,583,000), respectively. For the fiscal year ended June 30, 2018, total operating revenue and revenues in excess (deficit) of expenses attributable to CHHA were $61,916,000 and $(636,442), respectively.

Pro Forma Financial Information

Had the acquisitions of LAMC, Imperial, GSHS, and CHHA occurred as of July 1, 2016, the unaudited pro forma total operating revenue and revenues in excess of expenses before the effect of non-controlling interest of CHRISTUS would have been $5,380,684,000 and $159,673,000, respectively, for the fiscal year ended June 30, 2018, and $5,119,582,000 and $47,708,000, respectively, for the fiscal year ended June 30, 2017. In calculating these unaudited pro forma numbers, the effects of the inherent contribution and related transaction costs have been excluded, and the effects of incremental depreciation resulting from recording acquired long-lived assets have been included.

Sale of Controlling Interest

Long-Term Acute Care

On August 1, 2017, CHRISTUS Continuing Care executed an asset contribution agreement, under which CHRISTUS contributed substantially all of the assets of its long-term acute care hospitals to a newly formed entity, Southwest Partnership, a joint venture between CHRISTUS Continuing Care and various subsidiaries of The LHC Group (LHC). The contribution was made in exchange for $4,506,000 cash proceeds and a 7.28% non-controlling interest in Southwest Partnership. This retained interest was valued at $3,004,000 based on the results of an independent valuation of the business value of Southwest Partnership using a discounted cash flow model. The transaction closed on September 1, 2017, and CHRISTUS recorded a gain from the sale of $3,436,000, which is included in other revenue including gain on contribution to joint ventures.

Home Care

On August 1, 2017, CHRISTUS Continuing Care executed an asset contribution agreement, under which CHRISTUS contributed substantially all of the assets of its home care business to Southwest Partnership.

18. Significant Events (continued)

The contribution was made in exchange for $20,250,000 cash proceeds and a 32.72% non-controlling interest in Southwest Partnership. This retained interest was valued at $13,500,000 based on the results of an independent valuation of the business value of Southwest Partnership using a discounted cash flow model. The transaction closed on September 1, 2017, and CHRISTUS recorded a gain from the sale of $32,904,000, which is included in other revenue including gain on contribution to joint ventures.

Houston Methodist St. John and St. Catherine

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

Hurricane Harvey

In August 2017, various hospitals and other physical structures in the CHRISTUS Spohn, CHRISTUS Southeast Texas, CHRISTUS Gulf Coast, and CHRISTUS Louisiana Regions sustained damage from Hurricane Harvey resulting in property damage and business interruption. CHRISTUS maintains property and business interruption insurance coverage through independent property and casualty companies. Additionally, CHRISTUS has self-insured property and casualty losses at the individual facility level through a wholly owned captive insurance company, Emerald Assurance. As of June 30, 2018, substantially all expected losses have been recorded and did not have a material impact on the financial position of the System. Total estimated damages sustained as a result of this event did not exceed the System's self-insured retention limits.

19. Subsequent Events

The System evaluated events and transactions occurring subsequent to June 30, 2018 through September 20, 2018, the date of issuance of the consolidated financial statements. During this period, there were no subsequent events requiring recognition in the consolidated financial statements. However, the following events and transactions occurred that warrant disclosure.

Effective September 1, 2018, CHRISTUS and Ochsner Clinic Foundation (Ochsner) executed a membership interest purchase agreement, whereby Ochsner acquired a 40% non-controlling membership interest in CHRISTUS Health Southwest Louisiana (SWLA) for $59,329,000, subject to certain working capital and other adjustments. The purchase price was paid with $35,000,000 in cash and the remaining amount in the form of a five-year promissory note. CHRISTUS and Ochsner also executed a Clinic Services Agreement, under which Ochsner will manage SWLA's physician clinics and physician-employee medical practices. In connection with this transaction, SWLA was removed from the CHRISTUS Health Obligated Group.

Supplementary Information

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Building a better working world

Report of Independent Auditors on Supplementary Information

The Board of Directors
CHRISTUS Health

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

Ernst & Young LLP

September 20, 2018

CHRISTUS Health

Community Benefit (Unaudited)

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

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

	2018	2017
	(Unaudited)	
Programs and services for the poor and underserved:		
Charity care at unpaid cost	**$ 268,435**	$ 246,550
Unpaid cost of Medicaid and other public programs	**92,222**	74,420
Community services for the poor and underserved	**41,043**	40,369
Total programs and services for the poor and underserved	**401,700**	361,339
Community services for the broader community:		
Education and research	**5,772**	2,399
Other community services	**14,750**	4,102
Total community services for the broader community	**20,522**	6,501
Total community benefits	**$ 422,222**	$ 367,840

The totals are calculated following CHA guidelines and adhere to the IRS Form 990, Schedule H methodology. CHRISTUS has multiple reporting requirements of charity care and community benefit, which vary based on the definitional and timing requirements of each requesting organization. For comparability, the unpaid cost of Medicaid and other public programs total for fiscal year 2017 has been updated to reflect the change in methodology effective for fiscal year 2018 reporting.

In addition to the community benefits reported above, the state of Texas requires that the unpaid costs of Medicare and other government-sponsored programs be reported. For the fiscal years ended June 30, 2018 and 2017, the unpaid costs of these programs were $145,110,000 and $334,463,000, respectively. The unpaid costs of the Medicare program represent the cost of providing services to primarily elderly beneficiaries of the Medicare program, in excess of governmental and managed care contract payments. The unpaid costs of other government-sponsored programs represent the cost for providing health care services to the beneficiaries of the Department of Defense civilian care, included as per the state of Texas guidelines.

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