Memorial Hermann Health System

(UNAUDITED)

QUARTERLY REPORT ON FINANCIAL INFORMATION AND OPERATING DATA

Fiscal Quarter Ended

March 31, 2018

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Consolidated Financial Statements (Unaudited)

Memorial Hermann Health System
Nine Months Ended March 31, 2018 and 2017
With Report of Independent Auditors

Memorial Hermann Health System

Consolidated Financial Statements (Unaudited)

March 31, 2018

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Review Report of Independent Auditors

The Board of Directors
Memorial Hermann Health System

We have reviewed the consolidated financial information of Memorial Hermann Health System (the Health System), which comprise the consolidated balance sheet as of March 31, 2018, and the related consolidated statements of operations and changes in net assets and cash flows for the nine-month periods ended March 31, 2018 and 2017.

Management's Responsibility for the Financial Information

Management is responsible for the preparation and fair presentation of the interim financial information in conformity with U.S. generally accepted accounting principles; this includes the design, implementation and maintenance of internal control sufficient to provide a reasonable basis for the preparation and fair presentation of interim financial information in conformity with U.S. generally accepted accounting principles.

Auditor's Responsibility

Our responsibility is to conduct our review in accordance with auditing standards generally accepted in the United States applicable to reviews of interim financial information. A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States, the objective of which is the expression of an opinion regarding the financial information. Accordingly, we do not express such an opinion.

Conclusion

Based on our review, we are not aware of any material modifications that should be made to the consolidated financial information referred to above for it to be in conformity with U.S. generally accepted accounting principles.

Ernst + Young LLP

April 30, 2018

Memorial Hermann Health System

Consolidated Balance Sheets

		March 31, 2018 (unaudited)		June 30, 2017 (audited)
		(In Thousands)		
Assets				
Current assets:				
Cash and cash equivalents, including $5,270 and $27,334 of assets limited as to use as of March 31, 2018 and June 30, 2017, respectively	**$**	**357,076**	$	337,551
Patient accounts receivable, net of allowances for bad debt (March 31, 2018 – $696,770; June 30, 2017 – $702,890)		**684,290**		654,465
Other current assets		**174,037**		214,895
Total current assets		**1,215,403**		1,206,911
Investments		**2,281,276**		2,159,276
Assets limited as to use, less current portion		**265,576**		335,068
Property, plant, and equipment, net		**2,992,220**		2,905,581
Other assets		**215,531**		212,753
Total assets	**$**	**6,970,006**	$	6,819,589
Liabilities and net assets				
Current liabilities:				
Accounts payable	**$**	**231,785**	$	299,452
Accrued payroll and related expenses		**239,974**		218,504
Other accrued expenses		**203,482**		206,426
Current portion of long-term debt, including capital lease obligations		**54,282**		51,654
Long-term debt subject to liquidity agreements		**383,801**		383,721
Total current liabilities		**1,113,324**		1,159,757
Long-term debt, including capital lease obligations		**1,893,730**		1,870,843
Other long-term obligations		**536,391**		528,844
Total liabilities		**3,543,445**		3,559,444
Net assets, including noncontrolling interest of $126,989 and $124,936 as of March 31, 2018 and June 30, 2017, respectively		**3,426,561**		3,260,145
Total liabilities and net assets	**$**	**6,970,006**	$	6,819,589

See accompanying notes.

Memorial Hermann Health System

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

	Nine Months Ended March 31, 2018	Nine Months Ended March 31, 2017
	(In Thousands)	
Revenues, gains, and other support:		
Net patient service revenue before bad debt provision	**$ 4,321,489**	$ 4,031,377
Provision for bad debt	**(719,970)**	(556,321)
Net patient service revenue	**3,601,519**	3,475,056
Premium revenue, net	**110,552**	121,781
Other revenue	**197,425**	195,421
Total revenues, gains, and other support	**3,909,496**	3,792,258
Expenses:		
Salaries, benefits, and related personnel costs	**1,725,460**	1,710,085
Services and other	**1,092,337**	1,041,068
Supplies and medicines	**683,238**	640,999
Outside medical claims	**71,863**	65,886
Depreciation and amortization	**214,702**	200,998
Interest	**69,794**	66,097
Total expenses	**3,857,394**	3,725,133
Operating income	**52,102**	67,125
Nonoperating activities:		
Investment gains, net	**138,000**	185,678
Interest rate swap agreements	**10,529**	31,483
Revenues in excess of expenses	**200,631**	284,286
Revenues in excess of expenses attributable to noncontrolling interests	**(45,865)**	(46,966)
Revenues in excess of expenses attributable to the Health System	**154,766**	237,320
Other changes in net assets:		
Contributions and grants received and other changes in net assets, net	**9,597**	16,123
Change in noncontrolling interests	**2,053**	(3,143)
Change in net assets	**166,416**	250,300
Net assets at beginning of year	**3,260,145**	2,947,140
Net assets at end of peiod	**$ 3,426,561**	$ 3,197,440

See accompanying notes.

Memorial Hermann Health System

Consolidated Statements of Cash Flows (Unaudited)

	Nine Months Ended March 31, 2018	Nine Months Ended March 31, 2017
	(In Thousands)	
Operating activities		
Cash received for patient services	**$ 3,634,895**	$ 3,492,722
Cash paid to or on behalf of employees	**(1,685,773)**	(1,698,257)
Cash paid for supplies and services	**(1,941,832)**	(1,766,458)
Other receipts from operations, including premiums	**318,443**	339,702
Investment gains realized	**55,161**	26,322
Interest paid	**(68,716)**	(62,444)
Net cash provided by operating activities	**312,178**	331,587
Investing activities		
Capital expenditures, net	**(260,588)**	(299,002)
Change in assets limited as to use	**65,399**	103,853
Change in investments	**(52,089)**	(48,085)
Other	**–**	91
Net cash used in investing activities	**(247,278)**	(243,143)
Financing activities		
Payments on long-term debt and note payable	**(11,345)**	(4,233)
Restricted contributions	**8,503**	20,093
Noncontrolling interest	**(42,533)**	(43,992)
Net cash used in financing activities	**(45,375)**	(28,132)
Net increase in cash and cash equivalents	**19,525**	60,312
Cash and cash equivalents at beginning of year	**337,551**	307,689
Cash and cash equivalents at end of period	**$ 357,076**	$ 368,001
Supplemental information – reconciliation of change in net assets to net cash provided by operating activities		
Change in net assets	**$ 166,416**	$ 250,300
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	**214,702**	200,998
Unrealized net gain on investments and interest swap agreements	**(93,722)**	(190,803)
Other changes in net assets	**51,535**	17,434
Change in patient accounts receivable, net of provision for bad debt	**(29,825)**	(4,031)
Change in other assets	**38,086**	39,995
Change in accounts payable, accrued payroll, and other accrued expenses	**(59,410)**	11,742
Change in other long-term obligations	**24,396**	5,952
	145,762	81,287
Net cash provided by operating activities	**$ 312,178**	$ 331,587

See accompanying notes.

Memorial Hermann Health System

Notes to Consolidated Financial Statements (Unaudited)

March 31, 2018

1. Mission and Organization

Memorial Hermann Health System (the Health System), a Texas nonprofit membership corporation, controls and coordinates the activities of certain other affiliates. The Health System Board of Directors exercises governance control for the Health System and retains significant reserved powers regarding its affiliates. The Health System is exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code (IRC). The Health System owns and operates 13 nonsectarian general acute care hospitals (including Memorial Hermann – Texas Medical Center, the primary teaching hospital for The McGovern Medical School of The University of Texas Health Science Center at Houston), a research and rehabilitation hospital (TIRR) in the Texas Medical Center, a Medicare-certified home health agency, and a comprehensive ambulatory care network of facilities and services — all serving to position Memorial Hermann Health System as the market leader in the greater Houston, Texas, area. The Health System includes one of the nation's largest Independent Practice Association models, through which more than 5,000 physicians are clinically integrated and affiliated with the Health System for clinical practice standards, two insurance companies that underwrite group health coverage for employers and the Medicare Advantage program, a captive casualty and liability insurance company, and an accountable care organization. Additionally, the Health System is supported by the Memorial Hermann Foundation (the Foundation). The consolidated financial statements include the accounts of the Health System and its controlled affiliates. All significant intercompany accounts and transactions have been eliminated.

2. Significant Accounting Policies

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses, and disclosure of contingent assets and liabilities, at the date of the financial statements. Because of the subjectivity inherent in this process, actual results may differ from those estimates. In the opinion of management, all adjustments considered necessary for a fair presentation have been included and are of a normal recurring nature. Operating results for the nine months ended March 31, 2018 are not necessarily indicative of the results expected for the year ending June 30, 2018.

2. Significant Accounting Policies (continued)

Subsequent Events

The Health System evaluates the impact of subsequent events, events that occur after the balance sheet date but before the financial statements are issued, for potential recognition in the consolidated financial statements as of the consolidated balance sheets' date or disclosure in the notes to the consolidated financial statements. The Health System evaluated events occurring subsequent to March 31, 2018 through April 30, 2018, the date on which the accompanying consolidated financial statements were issued.

Net Assets and Contributions

To ensure compliance with restrictions placed on the resources available to the Health System, the Health System's accounts are maintained in accordance with the existence or absence of donor-imposed restrictions. This is the procedure by which resources are classified for accounting and reporting into funds established according to their nature and purposes. In the consolidated financial statements, funds that have similar characteristics have been consolidated into three net asset categories: permanently restricted, temporarily restricted, and unrestricted.

- Permanently restricted net assets contain donor-imposed restrictions that stipulate the resources be maintained permanently, but permit the Health System to use the income derived from the donated assets for donor-specified purposes.

- Temporarily restricted net assets contain donor-imposed restrictions that permit the Health System to use or expend the assets as specified. The restrictions are satisfied either by the passage of time or by actions of the Health System.

- Unrestricted net assets are not restricted by donors, or the donor-imposed restrictions have expired or been met. When a donor restriction expires, 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.

At March 31, 2018 and June 30, 2017, the Health System had $142,158,000 and $137,212,000, respectively, in restricted net assets.

Unrestricted and restricted donations are recognized when received. Unrestricted and restricted pledges are reported as revenue in the period the pledge is made at the present value of estimated future cash flows. Amortization of the discount is included in contribution income. Pledges are

2. Significant Accounting Policies (continued)

recorded net of an allowance for uncollectibles. This allowance is determined based upon historical collection and write-off experience. Donor-restricted pledges and donations are recorded in the appropriate donor-restricted fund until restrictions are met, at which time they are contributed to the affiliate beneficiary. Gifts of property other than cash are recorded at fair market value at the dates the gifts are received.

The Health System holds donor-restricted endowment funds established primarily to fund specified activities for and within the Health System and the medical community as a whole. Net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

Contributions are recorded as revenue at the present value of estimated future cash flows when an unconditional promise is received. At March 31, 2018 and June 30, 2017, the Health System had $31,420,000 and $32,292,000, respectively, in pledges receivable, net of discount and allowance for uncollectibles of $1,272,000 for both periods. Pledges receivable are recorded as assets limited as to use in the accompanying consolidated balance sheets and are due, based on gross pledges, as follows:

	Pledges
March 31, 2019	$ 12,683,000
March 31, 2020	4,420,000
March 31, 2021	4,282,000
March 31, 2022	3,107,000
March 31, 2023	3,200,000
Thereafter	5,000,000

Net Patient Service Revenue and Patient Accounts Receivable

Net Patient Service Revenue

Net patient service revenue is reported at the estimated net realizable amounts from patients or third-party payors for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. For participants in the Medicare and Medicaid programs, and certain managed care programs, the Health System ultimately collects amounts that are generally less than standard charges. Medicare and Medicaid are federal and state programs generally designed to provide services to elderly and indigent patients, respectively. Medicare and Medicaid together constituted 51% and 50% of the Health System's

2. Significant Accounting Policies (continued)

standard charges for each of the nine-month periods ended March 31, 2018 and 2017, respectively. The Health System has also entered into multiple payment agreements with commercial insurance carriers, health maintenance organizations, and preferred provider organizations (managed care companies). The basis for payment to the Health System under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined fee schedules for episodic services. The revenues derived from these agreements constituted 37% and 38% of the Health System's standard charges for each of the nine-month periods ended March 31, 2018 and 2017, respectively.

Self-pay revenues are derived primarily from patients who do not have any form of health coverage. The revenues associated with self-pay patients are generally reported at the Health System's gross charges. The Health System evaluates these patients, after the patient's medical condition is determined to be stable, for their ability to pay based upon federal and state poverty guidelines and qualifications for Medicaid or other governmental assistance programs, as well as the Health System's policy for charity care. The Health System provides care without charge to certain patients who qualify under its charity care policy.

The Health System classifies revenues and receivables for patients who do not have any form of health coverage upon treatment, but who the Health System expects will qualify for coverage under the Medicaid program, as Medicaid with corresponding contractual adjustments for uncollectible amounts.

The Health System's net patient service revenue before bad debt by payor, and approximate percentages of total, were as follows for the nine-month periods ended March 31 (in thousands):

	2018		**2017**	
	Amount	**Ratio**	**Amount**	**Ratio**
Managed care	**$ 2,020,594**	**47%**	$ 1,936,654	48%
Medicare	**1,029,651**	**24**	897,029	22
Medicaid	**465,242**	**11**	498,884	12
Self-pay	**678,559**	**16**	545,163	14
Other	**127,443**	**2**	153,647	4
Total	**$ 4,321,489**	**100%**	$ 4,031,377	100%

2. Significant Accounting Policies (continued)

Patient Accounts Receivable

Patient accounts receivable are reported net of estimated allowances for contractual allowances, bad debt, and other discounts. The Health System's recorded allowances for bad debt are 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 conditions. Unpaid accounts are written off as bad debts upon reaching delinquent status. Charity care accounts are written off as identified or qualified under the Health System's charity care policy. The Health System's concentration of credit risk with respect to patient accounts receivable is limited due to the diversity of patients and payors.

The Health System's accounts receivable by payor as a percentage of total accounts receivable were as follows at March 31, 2018 and June 30, 2017:

	March 31, 2018	June 30, 2017
Managed care	**27%**	29%
Medicare	**21**	21
Medicaid	**17**	15
Self-pay	**24**	25
Other	**11**	10
Total	**100%**	100%

A summary of activity in the Health System's allowance for bad debt is as follows (in thousands):

	Balances at Beginning of Period	Provision for Bad Debt, Net of Recoveries	Accounts Written Off	Balances at End of Period
Period ended March 31, 2018	**$ 702,890**	**$ 719,970**	**$ (726,090)**	**$ 696,770**
Year ended June 30, 2017	735,260	656,675	(689,045)	702,890

2. Significant Accounting Policies (continued)

Medicare and Medicaid Programs

While laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation, the Health System intends to be in compliance with all applicable laws and regulations and, to that end, has implemented a comprehensive organization-wide corporate compliance policy.

Annual retroactive settlements with the Medicare and Medicaid programs are subject to review by appropriate governmental authorities or their agents. Settlements are accrued on an estimated basis in the period the related services are rendered, and adjusted in future periods as final settlements are determined. Accruals for possible settlements are calculated based on historical experience.

The Health System's Medicare and Medicaid cost reports have been audited by the applicable fiscal intermediary through June 30, 2014, for all hospitals and up to 2015 for certain entities. However, certain prior cost reports have been reopened by the fiscal intermediary for further review. Additionally, from time to time, the Health System appeals decisions of the fiscal intermediary in order to recover funds it believes are appropriately due to the Health System for services rendered to Medicare and/or Medicaid beneficiaries. Processes related to recovering these funds are often long and complex. The Health System's policy is to record any funds received from appeals as income in the year in which the notice of cost report settlement is received.

At March 31, 2018 and June 30, 2017, aggregate accruals and allowances for possible settlements, and pending reviews, as discussed above, of $41,131,000 and $41,575,000, respectively, are included in the accompanying consolidated balance sheets in other accrued expenses. It is reasonably possible that these estimates could differ from actual settlements and, thus, change in the near term by material amounts.

During the nine-month periods ended March 31, 2018 and 2017, the Health System recognized $21,204,000 and $10,674,000, respectively, in net patient service revenue from differences between estimated and actual cost report settlements and appeals.

Medicaid Supplemental Payments

During fiscal years 2018 and 2017, the Health System participated in the Medicaid Disproportionate Share hospital funding program, established by the state of Texas and

2. Significant Accounting Policies (continued)

administered by the Texas Health and Human Services Commission (HHSC), which created additional federal matching funds to increase access to health care by Texas' indigent patients and defray the cost of treating indigent patients. Funds are distributed to hospitals providing a high volume of services to Medicaid and uninsured patients. During fiscal year 2012, a new Medicaid supplemental payment program was established in Texas under an 1115 Waiver (Waiver). The Waiver program was initially a five-year federally approved program designed to supplement the unreimbursed costs of providing care to Medicaid and uninsured patients, as discussed in Note 3. This program has been extended until September 2022. There are two pools of funds established under the Waiver program: an uncompensated care (UC) pool and a delivery system reform incentive payment (DSRIP) pool. To receive payments from the UC pool, a hospital must submit an application (referred to as the Waiver tool) estimating its uncompensated costs for services provided to Medicaid and uninsured patients. In March 2018, an additional Mediciad supplemental fund program, the Uniform Hospital Rate Increase Program (UHRIP) was implemented. As part of this program, hospital providers receive an additional payment for Medicaid managed care patients from the plans for which the hospital is the participant. The funding of these programs are dependent on intergovernmental transfers from state-owned and local governmental entities to draw down federal funds to finance both pools. Medicaid supplemental funds, which include Medicaid Disproportionate Share, DSRIP, UC, and UHRIP payments, of approximately $186,570,000 and $262,968,000 were recorded for the nine-month periods ended March 31, 2018 and 2017, respectively. Net patient service revenue includes UC, UHRIP, and Disproportionate Share supplemental funds as a reduction of contractual allowances. DSRIP is recorded as other revenue. At March 31, 2018 and June 30, 2017, the Health System has receivables recorded of $9,058,000 and $62,469,000 for UC Medicaid supplemental payments, respectively. These amounts are included in other current assets in the accompanying consolidated balance sheets. Medicaid supplemental payments have been recognized based on the most recent information available, but it is reasonably possible that the recorded estimates may change by a material amount in the near term. Management believes adequate allowance has been provided for possible adjustments that might result from adjustments to the Medicaid supplemental payment programs.

Premium Revenues, Claims Payable, and Medical Claims Expenses

Premium revenues are recognized in the month in which members are entitled to health care services. Premiums collected in advance are recorded as unearned premiums and are included in accrued liabilities on the accompanying consolidated balance sheets.

2. Significant Accounting Policies (continued)

The estimated cost of all health services rendered to members through March 31, 2018 and June 30, 2017 but not yet paid as of that date is included in other accrued expenses. This claims expense estimate is developed using actuarial assumptions based on historical experience with respect to the timing of payments in relation to the dates of service. Subsequent changes to prior period estimates are reflected in the current period.

Cash Equivalents

Liquid investments with an original maturity of three months or less are reported as cash equivalents, except for those held for long-term investing purpose or subject to restrictions, which are reported as investments or assets limited to use.

Investments, Assets Limited to Use, and Investment Income

Investments are reflected as investments or assets limited as to use in the consolidated balance sheets and include fixed income, equity securities, master limited partnerships (MLPs), and alternative investments. Investments in equity securities and all debt securities are carried at fair value. Fixed income includes U.S. government securities, mortgage-backed securities, asset-backed securities and other securitized credit, corporate obligations, and non-U.S. sovereign and corporate securities, in pooled funds and separate accounts. Equity securities include domestic and international equities in pooled funds and separate accounts. Pooled funds are professionally managed and include institutional mutual funds, fixed income funds, equity funds, and commingled accounts. MLPs include domestic MLPs in pooled funds and separate accounts and represent limited partnerships that are typically publicly traded. Other characteristics often associated with these MLPs include the requirement that the partnerships must generate most of their cash flows from particular businesses (including commodities).

Alternative investments include ownership interests in hedge funds and limited partnerships that may employ various investment strategies through the use of publicly traded securities, market neutral arbitrage, floating rate loans and debt securities, fixed income swaps, private real assets, and private equity. The Health System's alternative investments include certain investments whose reported values had been estimated by fund managers in the absence of readily available market values or cannot otherwise be substantiated. Because of the inherent uncertainty of valuations, fund managers' estimates of fair value may differ from the values that would have been used had a ready market for the securities existed, and the differences could be material. Additionally, risks in certain of the Health System's alternative investments include limited transparency where funds are not required to disclose the holdings in their portfolios to the

2. Significant Accounting Policies (continued)

Health System and limitations on liquidity as funds may impose lockup periods or holdback provisions that limit the Health System's ability to redeem those investments. The Health System records its alternative investments at estimated fair value. As of March 31, 2018, the unfunded commitment related to alternative investments is approximately $318,509,000.

Investments are classified as noncurrent assets, regardless of their maturity date due to the Health System's primary intent not to utilize these assets to meet current obligations, capital, and other cash flow needs, and the investments have exposure to asset classes with longer term investment horizons. Assets limited as to use are funds legally restricted by bond indentures, internally restricted in connection with self-insurance programs, externally restricted by donor specifications, restricted by resident agreements, or internally restricted for charity care or other purposes. Assets limited as to use are classified as noncurrent assets, except for assets limited as to use that are required to meet current liabilities, which are classified as current assets.

Substantially all of the Health System's investments are designated as trading investments. Investment income, including realized and unrealized gains and losses on investments, interest and dividend income, and equity in earnings of alternative investments, is recorded as a nonoperating activity and included in revenues in excess of expenses in the accompanying consolidated statements of operations and changes in net assets, unless the income or loss is restricted by donor or law. Net purchases and sales of investments are reported as a component of net cash used in investing activities in the accompanying consolidated statements of cash flows, as the net proceeds were used primarily to fund the Health System's acquisition of capital assets.

The Health System maintains investments with various financial institutions and investment management firms, and its policy is designed to limit exposure to any one institution or investment, therefore reducing overall risk.

Property, Plant, and Equipment

Property, plant, and equipment are carried at cost or fair value at the time of donation and include expenditures for new facilities and equipment and those expenditures that substantially increase the useful life of existing facilities and equipment. Ordinary maintenance and repairs are charged to expense when incurred. Depreciation is provided using the straight-line method over 20 to 40 years for buildings, 5 to 10 years for improvements (limited to the term of the related lease, if applicable), and 3 to 12 years for equipment. Assets accounted for as capital leases are

2. Significant Accounting Policies (continued)

amortized over the terms of the respective leases, and such amortization is included in depreciation and amortization expense.

When events, circumstances, or operating results indicate that the carrying values of certain long-lived assets might be impaired, the Health System prepares undiscounted projections of cash flows expected to result from the use of the assets and their eventual disposition. If the projections indicate that the recorded amounts are not expected to be recoverable, the related asset's carrying value is reduced to estimated fair value. Fair value may be estimated based upon internal evaluations that include quantitative analyses of revenues and cash flows, reviews of recent sales of similar assets, and independent appraisals. Property and equipment to be disposed of are reported at the lower of the carrying amounts or fair value less costs to sell or close. The estimates of fair value are usually based upon recent sales of similar assets and market responses based upon discussions with and offers received from potential buyers.

Interest Rate Swap Agreements

The Health System records its interest rate swap agreements at fair value in the consolidated balance sheets and the change in the fair values and net interest payments under swaps as a component of interest rate swap agreements on the consolidated statements of operations and changes in net assets.

Investments in Joint Ventures

The Health System has entered into multiple joint venture and partnership arrangements for the provision of medical services to patients. For those ventures where the Health System has a controlling interest through majority ownership, management control, or both, the ventures' assets, liabilities, and operating results have been included in the consolidated financial statements of the Health System. At March 31, 2018 and June 30, 2017, the Health System has recognized net assets attributable to noncontrolling interest of $126,989,000 and $124,936,000, respectively, representing the venture partners' interest in the equity and undistributed earnings of the consolidated ventures. For those ventures where the Health System does not maintain a controlling interest, the Health System accounts for its investment under the equity method of accounting.

2. Significant Accounting Policies (continued)

Goodwill

The Health System records goodwill arising from a business combination as the excess of the purchase price and related costs over the fair value of the identifiable tangible and intangible assets acquired and liabilities assumed. At March 31, 2018 and June 30, 2017, the Health System had goodwill of $197,338,000 and $195,110,000, respectively, which relates to the purchase of several entities from 2010 to 2017, including purchases made by consolidated joint ventures. Goodwill is reflected in other long-term assets.

Taxes

The Health System and certain other affiliates are Texas nonprofit corporations and have been recognized as tax-exempt pursuant to Section 501(c)(3) of the IRC. The Health System owns certain taxable subsidiaries and engages in certain activities that are unrelated to its exempt purpose and, therefore, subject to tax.

Management annually reviews its tax positions and has determined that there are no material uncertain tax positions that require recognition in the accompanying consolidated balance sheets. The tax returns are subject to Internal Revenue Service review for three years subsequent to the dates they are filed. The Health System has net operating losses (NOL) tax carryforwards that will expire between 2019 and 2037. Due to the age of these NOLs and the fact that management is uncertain that the full amount of the NOLs will be realized in the future, no deferred tax asset has been recorded.

The Tax Cuts and Jobs Act (the Act) was enacted on December 22, 2017. Among other provisions, the Act reduces the US federal corporate tax rate from 35% to 21%. Management does not expect that the Act will materially impact the current financial statements of the Health System.

Performance Indicator

The Health System's consolidated statements of operations and changes in net assets contain a performance indicator titled revenues in excess of expenses. Revenues in excess of expenses include the Health System's results from operations and nonoperating activities, and exclude changes in noncontrolling interest, changes in unfunded pension obligations, restricted contributions and grants received, and certain other changes in net assets. Health System activities directly related to the furtherance of the Health System's purpose, as discussed in

2. Significant Accounting Policies (continued)

Note 1, are considered to be operating activities. Other activities that result in gains or losses are considered to be nonoperating and primarily include investment earnings, losses on extinguishment of debt, and other nonoperating gains/losses, including unusual or infrequent recoveries or costs not directly related to operating activities.

Pending Accounting Pronouncements

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*, 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. 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.

Management is in the process of completing its evaluation of the requirements of the new standard to insure that the Health System has processes, systems and internal controls in place to collect the necessary information to implement the standard. It is management’s current intention to use a modified retrospective method of application to adopt ASU 2014-09. Management intends to use a portfolio approach to apply the new model to classes of payers with similar characteristics and will analyze cash collection trends over an appropriate collection look-back period. Adoption of ASU 2014-09 will result in changes to the Health System’s presentation for and disclosure of revenue related to uninsured or underinsured patients. Currently, a significant portion of the Health System’s provision for doubtful accounts relates to self-pay patients. Under ASU 2014-09, the estimated uncollectable amounts due from these patients will generally be considered a direct reduction to net operating revenues and, correspondingly, will result in a material reduction in the amounts presented separately as provision for doubtful accounts. Management is also in the process of assessing the impact of the new standard on various reimbursement programs that represent variable consideration. 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 net operating revenues in the Health System’s consolidated statements of operations and on certain disclosures, management does not expect it to materially impact the Health System’s financial position, results of operations or cash flows. Management believes that the cumulative effect of the change in accounting principle effective July 1, 2018, if any, will be immaterial.

2. Significant Accounting Policies (continued)

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. ASU 2016-02 requires companies that lease assets to recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, in their balance sheets. The pronouncement will also require additional disclosures about the amount, timing and uncertainty of cash flows arising from leases. The provisions of ASU 2016-02 are effective for the Health System starting July 1, 2019, including interim periods within that reporting period, and early adoption is permitted. Management is currently evaluating the impact of this pronouncement on the Health System's consolidated financial statements.

In August 2016, the FASB issued ASU 2016-14, *Not-for-Profit Entities (Topic 958)*. ASU 2016-14 sets forth the FASB's improvements to net asset classification requirements and the information presented about a not-for-profit entity's liquidity, financial performance, and cash flows. The provisions of ASU 2016-14 are effective for the Health System's annual financial statements for the fiscal year starting July 1, 2018, and early adoption is permitted. Application to interim financial statements is permitted but not required in the initial year of application, but is required starting July 1, 2019. Management is currently evaluating the impact of this pronouncement on the Health System's consolidated financial statements.

In March 2017, the FASB issued ASU 2017-07, *Compensation – Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. The amendments in ASU 2017-07 require that an employer report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. It also requires the other components of net periodic pension cost and net periodic postretirement benefit cost to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations. The provisions of ASU 2017-07 are effective for the Health System starting July 1, 2018, including interim periods within that reporting period, and early adoption is permitted. Management has determined the impact will be immaterial to the financial statements.

3. Community Service

In accordance with its purpose and values, the Health System is committed to providing high-quality, cost-effective health services to the community, including such underserved groups as the indigent and the elderly. Self-pay revenues are derived primarily from patients who do not have any form of health coverage. The revenues associated with self-pay patients are generally reported at the Health System's gross charges. The Health System evaluates these patients, after

3. Community Service (continued)

the patient's medical condition is determined to be stable, for their ability to pay based upon federal and state poverty guidelines, or qualifications for Medicaid or other governmental assistance programs, as well as the Health System's policy for charity care. The Health System provides care without charge to certain patients who qualify under the local charity care policy. The Health System's gross charity care charges include only services provided to patients who are unable to pay and qualify under the Health System's charity care policies. The Health System does not report a charity care patient's charges in revenues or in the provision for doubtful accounts, as it is the Health System's policy not to pursue collection of amounts related to these patients.

In addition, the Health System contributes to Harris County Clinical Services, Inc. (HCCS), which provides health care services to low-income and needy residents in the community. The Health System's management estimates its costs of care provided under its charity care programs utilizing a calculated ratio of costs to gross charges multiplied by the Health System's gross charges provided. These costs are as follows for the nine-month periods ended:

	March 31,	
	2018	**2017**
	(In Thousands)	
Charity care costs	**$ 166,432**	$ 176,754
HCCS payments	**108,475**	107,597
	$ 274,907	$ 284,351

The Health System operates emergency rooms at its hospitals that are open to the public 24 hours a day, 7 days a week. The Health System also operates Life Flight, an air ambulance service based at Memorial Hermann – Texas Medical Center (Level I trauma center); a burn unit; a transplant center; and two Level III neonatal intensive care units that provide services to many infants whose mothers have not had access to appropriate prenatal care. Further, the Health System provides various community screenings for the detection of diseases and disorders, as well as a forum for various wellness activities and community health education classes.

In addition to the uncompensated care provided to patients, the Health System funds various community projects as part of its ongoing community benefit plan. These projects are developed in response to specific community needs in the Health System's service area identified through community needs assessments. Examples of projects funded include 10 school-based health centers and three mobile dental vans serving 72 schools in five school districts, an ER Navigator

3. Community Service (continued)

program educating primary care patients about the importance of finding an appropriate medical home other than the emergency room, and providing financial support to primary care clinics that serve the community's uninsured and underinsured population. Additionally, the Health System supports various community and city-wide task forces committed to addressing the issue of health access for the underserved.

As a part of its approval of the 1997 merger between Memorial Hospital System and Hermann Healthcare System, Inc., a Harris County District Court entered an Agreed Order stipulating that Memorial Hermann -Texas Medical Center will continue providing charity care and community service in the amount of 6% of net revenue or $22,500,000, whichever is greater. This amount is an additional 1% above the percentage required of all Texas nonprofit hospitals under the charity care provision of the Texas Health & Safety Code. During fiscal years 2018 and 2017, the Health System believes it has met all stipulations of the agreement. Revenues of the other Health System entities are not obligated under the agreement.

4. Investments and Assets Limited as to Use

Investments

The Health System maintains investments with various financial institutions and investment management firms, and its policy is designed to limit exposure to any one institution or investment, therefore reducing overall investment risks. The following is a summary of unrestricted investments by classification:

	March 31, 2018	**June 30, 2017**
	(In Thousands)	
Cash and cash equivalents	**$ 17,780**	$ 48,631
Fixed income	**357,742**	410,183
Equity securities	**982,146**	993,406
Alternative investments	**923,608**	707,056
Total investments	**$ 2,281,276**	$ 2,159,276

4. Investments and Assets Limited as to Use (continued)

Assets Limited as to Use

The following table sets forth the restricted purpose of the Health System's assets limited as to use:

	March 31, 2018	June 30, 2017
	(In Thousands)	
Bond indenture agreements	**$ –**	$ 117,387
Self-insurance programs and insurance companies restricted deposits	**120,341**	107,828
Donor restrictions	**146,547**	132,775
Charity care and depreciation funds	**3,958**	4,412
	270,846	362,402
Less current portion required for current liabilities	**(5,270)**	(27,334)
	$ 265,576	$ 335,068

Investment Income

Investment income related to unrestricted net assets comprises the following for the nine-month periods ended:

	March 31, 2018	March 31, 2017
	(In Thousands)	
Interest and dividend income	**$ 19,920**	$ 15,716
Realized gains, net	**46,306**	22,435
Unrealized gains, net	**71,774**	147,527
	$ 138,000	$ 185,678

5. Property, Plant, and Equipment

Property, plant, and equipment consist of the following:

	March 31, 2018	**June 30, 2017**
	(In Thousands)	
Buildings and improvements	**$ 3,164,468**	$ 3,030,644
Building and equipment under capital lease	**799,037**	757,191
Equipment	**2,084,675**	1,986,761
Less accumulated depreciation	**(3,573,798)**	(3,372,469)
	2,474,382	2,402,127
Land	**144,020**	144,020
Construction-in-progress	**373,818**	359,434
	$ 2,992,220	$ 2,905,581

At March 31, 2018, the Health System had remaining commitments for planned construction of approximately $469,580,000.

Under the provisions of ASC 840-40, *Leases – Sale-Leaseback Transactions*, the Health System is required to continue to capitalize medical office buildings sold and leased back and to recognize an obligation for the sales proceeds received. A gain on the sale of approximately $125,962,000 has been deferred until specified forms of continuing involvement have ceased. The medical office buildings are depreciated over the economic lives when placed in service. As of March 31 the following amounts are recorded in property, plant, and equipment, net and other long-term obligations:

	Property, Plant, and Equipment		**Other Long-term Obligations**	
	March 31, 2018	**June 30, 2017**	**March 31, 2018**	**June 30, 2017**
Medical office buildings and improvements	**$ 64,053,000**	$ 64,737,000	**$ 220,458,000**	$ 225,619,000

6. Indebtedness

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

	March 31, 2018	**June 30, 2017**
	(In Thousands)	
Obligations issued under the Memorial Hermann Health Master Trust Indenture:		
Revenue bonds, in variable rate demand mode, with interest rates ranging from 1.17% to 2.03% at March 31, 2018, due in varying installments through June 1, 2046:		
Series 2014C and D	**$ 70,400**	$ 70,400
Series 2015A, B and C	**255,600**	255,600
Series 2016B, C, D and E	**320,935**	320,935
Revenue bonds, in variable rate mode, with interest rate ranging from 1.58% to 2.16% at March 31, 2018, due in annual installments through December 1, 2042:		
Series 2013B	**78,275**	78,275
Series 2014B	**70,425**	70,425
Revenue bonds, in fixed rate mode, bearing interest from 2.40% to 5.30%, due in annual installments through July 1, 2046:		
Series 2010A	**41,230**	41,230
Series 2013A	**301,945**	308,870
Series 2014A	**139,775**	143,680
Series 2016A	**132,900**	132,900
Other long-term debt obligations:		
Capital lease obligations	**819,902**	779,238
Line of credit and other notes	**67,982**	68,972
	2,299,369	2,270,525
Premiums on long-term debt, net	**40,452**	44,118
Less deferred financing fees	**(8,008)**	(8,425)
	2,331,813	2,306,218
Less current portion, including amounts subject to self-liquidity	**(438,083)**	(435,375)
	$ 1,893,730	$ 1,870,843

6. Indebtedness (continued)

Debt Obligations

The Health System has issued revenue bonds through the Harris County Health Facilities Development Corporation and the Harris County Education Facilities Finance Corporation. Payments to the bondholders are funded by the issuing affiliates under a master trust indenture with the trustees of the respective bond issues. The Health System and substantially all operating affiliates have agreed to arrangements and indentures related to the bonds to abide by guidelines regarding repayment, financial performance, organizational changes, reporting, and additional borrowing. Certain variable rate demand bonds were issued under the Health System's self-liquidity program, and therefore, have been classified as current liabilities. The Health System will provide its own liquidity to purchase any tendered bonds that cannot be successfully remarketed.

In February 2017, the Health System renewed a syndicated revolving line of credit agreement for a term of five years with a maximum amount available of $300,000,000. The purpose of this line of credit facility is to provide a source of liquidity in the case of emergency or disaster, or to provide a means of bridge financing in advance of any permanent debt financing transaction. As of March 31, 2018 and June 30, 2017, $36,500,000 was outstanding for both periods and is due in February 2022.

On December 15, 2015, the Health System refinanced its Series 2010B ($162,400,000) variable rate demand bonds by issuing the Series 2015A ($81,200,000) and Series 2015B ($81,200,000) refunding bonds. These bonds were purchased by banks and have no "put feature" for a term of five years. The amortization and final maturity of the bonds remain unchanged.

On December 15, 2015, the Health System also refinanced its Series 2008A-1 ($107,800,000) variable rate demand bonds by issuing the Series 2015C ($107,800,000) refunding bonds. These bonds were purchased by a bank until the final maturity of the bonds and have no "put feature." The amortization and final maturity of the bonds remain unchanged.

The bank notes associated with the Series 2015A, Series 2015B, and Series 2015C bonds ($255,600,000 aggregate) contain certain criteria under which the respective banks can call for the repayment of the debt in advance of the stated maturities. Management has evaluated these criteria, and believes the debt is appropriately classified as long-term.

The Health System intends to convert the modes of Series 2015A, Series 2015B, and Series 2015C bonds in May 2018. Series 2015A and Series 2015B bonds ($162,400,000) will be

6. Indebtedness (continued)

converted to privately placed floating rate notes for a term of 3 years. Series 2015C bonds ($93,200,000) will be converted to variable rate demand bonds under the Health System's self-liquidity program and, therefore, will be classified as current liabilities. The amortization and final maturity of the bonds will remain unchanged.

On June 8, 2016, the Health System issued the Series 2016A fixed rate bonds in the amount of $132,900,000 due on July 1, 2046. The Series 2016A bonds were sold at a net premium of $18,316,215.

On June 8, 2016, the Health System issued the Series 2016B variable rate demand bonds in commercial paper mode in the amount of $150,000,000. On June 8, 2016, the Health System refinanced the 2013C and 2013D bonds by issuing the Series 2016C ($62,370,000) and 2016D ($41,605,000), which are variable rate demand bonds.

On June 8, 2016, the Health System restructured the Series 2008A-2 into 2016E Series ($72,300,000) variable rate demand refunding bonds.

The 2014C and D and 2016B, C, D, and E Series bonds were issued under the Health System's self-liquidity program and, therefore, have been classified as current liabilities.

Other notes consist of secured loans by financial institutions to finance the equipment purchases of the Health System's joint venture partnerships.

As of June 30, 2017, scheduled principal payments for outstanding debt (excluding capital leases and other notes) for the next five fiscal years are as follows: $40,520,000 in 2018, $42,055,000 in 2019, $41,135,000 in 2020, $40,280,0000 in 2021, and $42,090,000 in 2022.

The estimated fair value of the Health System's serial and term fixed rate bonds at March 31, 2018 and June 30, 2017 was approximately $665,037,000 and $691,328,000, respectively. The valuation of the bonds 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. The Health System considers the carrying value of its variable rate long-term debt to approximate fair value at March 31, 2018 and June 30, 2017, due to the variable nature of the interest rate.

6. Indebtedness (continued)

Leases

The Health System leases certain health facilities located in the Houston metropolitan area. One such leasing arrangement, which is reflected as a capital lease in the accompanying consolidated financial statements, consists of a 520-licensed-bed general acute care hospital and rehabilitation care facility located in west Houston. All revenues and income from the operation of the leased facilities during the lease term accrue to the Health System. The Health System is responsible under the lease for ad valorem taxes, normal maintenance, utilities, and other operating costs.

In June 2010, the Health System entered into 10-year lease agreements for additional floors of the Memorial City Medical Tower and for certain land, buildings, and improvements of medical offices currently existing near the Memorial City Medical Tower. These agreements are being recorded as operating leases with rental payments reflected in the accompanying consolidated statements of operations and changes in net assets.

The Health System leased certain other health facilities in the Houston metropolitan area, consisting of a 255-licensed-bed general acute care hospital in north Houston. All revenues and income from the operation of the leased facilities during the lease term accrue to the Health System. The Health System is responsible under the lease for ad valorem taxes, normal maintenance, utilities, and other operating costs. This agreement was recorded as an operating lease with annual rental payments of $6,500,000 reflected in the accompanying consolidated statements of operations and changes in net assets. In May 2016, the Health System purchased the leased facilities for $55,000,000. As part of the purchase agreement, the Health System has an obligation to operate the hospital for at least 10 years and to construct a new hospital tower with an expected cost of approximately $70,000,000 with the Northeast Hospital Authority contributing $10,000,000 toward the cost.

7. Interest Rate Swap Agreements

The Health System utilizes interest rate swap agreements to manage its capital costs and interest rate risk. The following table summarizes the Health System’s swap portfolio, the fair values at March 31, 2018 and June 30, 2017, the change in value, and the net amounts paid and received for the nine-month periods ended March 31, in thousands:

7. Interest Rate Swap Agreements (continued)

Swap Description	Term Date	Interest Rate Agreements	Aggregate Notional Amount	Fair Value Liability March 31, 2018	Fair Value Liability June 30, 2017	Change in Fair Value March 31, 2018	Change in Fair Value March 31, 2017
LIBOR-based to fixed (5.343%)	2032	1	$113,120	**($31,206)**	($38,665)	**$7,459**	$18,197
LIBOR-based to fixed (3.629%)	2029	3	131,700	**(18,855)**	(24,620)	**5,765**	11,934
LIBOR-based to fixed (3.635%)	2024	2	77,100	**(4,437)**	(6,918)	**2,481**	4,316
LIBOR-based to fixed (3.685%)	2027	3	159,800	**(13,886)**	(19,723)	**5,837**	10,681
		9	$481,720	**($68,384)**	($89,926)	**$21,542**	$45,128

The notional amounts under each of the interest rate swap agreements are reduced in conjunction with the Health System’s principal payments on the associated bonds. At March 31, 2018 and June 30, 2017, the fair value of swap agreements was a liability of $68,384,000 and $89,926,000, respectively, and has been included in other long-term liabilities in the accompanying consolidated balance sheets. As of March 31, 2018, none of the Health System’s swap agreements include provisions that would require posting of collateral.

The Health System classified the net interest cost on its interest rate swaps for the nine-month periods ended March 31, 2018 and 2017 of $11,013,000 and $13,645,000, respectively, in nonoperating expenses (interest rate swap agreements) in the consolidated statements of operations and changes in net assets.

8. Fair Value Measurement

The Health System categorizes, for disclosure purposes, assets and liabilities measured at fair value in the consolidated financial statements based upon whether the inputs used to determine their fair values are observable or unobservable. Observable inputs are inputs that are based on market data obtained from sources independent of the reporting entity. Unobservable inputs are inputs that reflect the reporting entity’s own assumptions about pricing the asset or liability, based on the best information available in the circumstances.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, an asset’s or liability’s level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement of the asset or liability. The Health System’s assessment of the significance of a particular input to the fair

8. Fair Value Measurement (continued)

value measurement in its entirety requires judgment, and considers factors specific to the asset or liability.

The Health System follows the three-level fair value hierarchy to categorize these assets and liabilities recognized at fair value at each reporting period, which prioritizes the inputs used to measure such fair values. Level inputs are defined as follows:

Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities on 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 unobservable for the asset or liability.

The following tables present financial instruments carried at fair value as of March 31, 2018 and June 30, 2017, on a recurring basis. The tables do not include contributions receivable of $31,420,000 and $32,292,000 at March 31, 2018 and June 30, 2017, respectively, and real estate of $187,000 that are not carried at fair value, and are included in assets limited as to use in the consolidated balance sheets. The tables also do not include Level 3 alternative investments of $957,077,000 and $747,024,000 at March 31, 2018 and June 30, 2017, respectively, which are measured at fair value using net asset value as a practical expedient, as allowed under ASU 2009-12, *Fair Value Measurements and Disclosures (Topic 820): Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent).* Valuations provided by the respective investment's management consider variables, such as the financial performance of underlying investments, recent sales prices of underlying investments, and other pertinent information. In addition, actual market exchanges at year-end provide additional observable market inputs of the exit price. The majority of these funds have restrictions on the timing of withdrawals, which may reduce liquidity, in some cases for up to 12 months.

8. Fair Value Measurement (continued)

	March 31, 2018			
	Level 1	Level 2	Level 3	Total
	(In Thousands)			
Assets				
Investments:				
Cash and equivalents	$ 17,780	$ –	$ –	$ 17,780
U.S. government securities	24,863	11,575	–	36,438
Pooled funds:				
Domestic equities	2,039	58,616	–	60,655
Global equities	166,253	185,014	–	351,267
Risk parity	35,009	34,239	–	69,248
Fixed income	210,454	–	–	210,454
Hedge fund	–	75,424	–	75,424
Corporate obligations	–	18,005	–	18,005
Corporate equities	283,454	–	–	283,454
Global equities	97,188	–	–	97,188
MLPs	120,334	–	–	120,334
Assets limited as to use:				
Cash and equivalents	106,062	–	–	106,062
Pooled funds:				
Domestic equities	10,038	–	–	10,038
Global equities	65,773	–	–	65,773
Fixed income	14,634	–	–	14,634
MLPs	5,309	–	–	5,309
Corporate equities	16,104	–	–	16,104
Total assets	$ 1,175,294	$ 382,873	$ –	$ 1,558,167
Liabilities				
Interest rate swap agreements	$ –	$ 68,384	$ –	$ 68,384
Total liabilities	$ –	$ 68,384	$ –	$ 68,384

8. Fair Value Measurement (continued)

	June 30, 2017			
	Level 1	**Level 2**	**Level 3**	**Total**
	(In Thousands)			
Assets				
Investments:				
Cash and equivalents	**$ 48,631**	**$ –**	**$ –**	**$ 48,631**
U.S. government securities	**12,077**	**28,328**	**–**	**40,405**
Pooled funds:				
Domestic equities	**1,845**	**52,376**	**–**	**54,221**
Global equities	**191,682**	**154,089**	**–**	**345,771**
Risk parity	**60,084**	**60,821**	**–**	**120,905**
Fixed income	**259,533**	**–**	**–**	**259,533**
Hedge fund	**–**	**69,330**	**–**	**69,330**
Public REITs	**36,324**	**–**	**–**	**36,324**
Corporate obligations	**–**	**15,699**	**–**	**15,699**
Corporate equities	**238,912**	**–**	**–**	**238,912**
Global equities	**62,896**	**–**	**–**	**62,896**
MLPs	**134,378**	**–**	**–**	**134,378**
Assets limited as to use:				
Cash and equivalents	**155,732**	**–**	**–**	**155,732**
Pooled funds:				
Domestic equities	**9,431**	**–**	**–**	**9,431**
Global equities	**57,081**	**–**	**–**	**57,081**
Fixed income	**46,812**	**–**	**–**	**46,812**
MLPs	**4,960**	**–**	**–**	**4,960**
Corporate equities	**13,820**	**–**	**–**	**13,820**
Total assets	**$ 1,334,198**	**$ 380,643**	**$ –**	**$ 1,714,841**
Liabilities				
Interest rate swap agreements	**$ –**	**$ 89,926**	**$ –**	**$ 89,926**
Total liabilities	**$ –**	**$ 89,926**	**$ –**	**$ 89,926**

The fair values of the securities included in Level 1 were determined through quoted market prices, and include money market funds, mutual funds, and marketable debt and equity securities. The fair values of Level 2 securities were determined through evaluated bid prices based on recent trading activity, and other relevant information, including market interest rate curves and referenced credit spreads, and estimated prepayment rates, where applicable, are used for valuation purposes and are provided by third-party services where quoted market values are

8. Fair Value Measurement (continued)

not available. The fair values of the interest rate swap agreements included in Level 2 were determined using third-party models that use as their inputs observable market conditions.

9. Self-Funded Liabilities

The Health System is self-insured for general and professional liability, errors and omissions, and workers' compensation claims, and maintains excess insurance coverage at varying levels. A provision is made for estimated losses and related expenses on risks not covered by insurance. The provision includes estimated amounts for asserted claims, reported incidents for which a claim has not been asserted, and claims incurred but not reported. The provision is based on specific claim loss estimates by the Health System's management and on estimates of total annual losses by an independent consulting actuary using the Health System and similar facility experience.

The Health Professionals Insurance Company, Ltd. (HePIC), a wholly owned subsidiary, is a captive insurance company that provides professional liability, general liability, and other insurance coverage for the Health System and its affiliates. The Health System funds HePIC's required insurance reserves. Funding amounts are based on actuarial recommendations. The assets of HePIC and the established liability for self-funded 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 consolidated statements of operations and changes in net assets. The Health System's established liability for self-funded losses was $84,231,000 and $65,361,000 as of March 31, 2018 and June 30, 2017, respectively, and is recorded in other long-term obligations in the accompanying consolidated balance sheets.

10. Commitments and Contingencies

Litigation

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

Various federal and state agencies have initiated investigations regarding reimbursement claimed by the Health System and other matters. The investigations are in various stages of discovery, and the ultimate resolution of these matters, including the liabilities, if any, cannot be readily

10. Commitments and Contingencies (continued)

determined; however, in the opinion of management, the results of these investigations will not have a material adverse impact on the consolidated financial statements of the Health System.

Other

Under terms of an agreement, as amended, dated January 1, 1968, the Health System and the University of Texas Health Science Center at Houston (the University) affiliated to operate and maintain a patient care, medical teaching, research, and community service facility. The agreement specifies that Memorial Hermann – Texas Medical Center will serve as the primary private hospital teaching site for the University, and operate and maintain a fully accredited hospital, while maintaining final authority over operational policy. The University agrees to offer the hospital the opportunity to accommodate all teaching programs and clinical programs, maintain fully accredited educational programs, and conduct research activities while utilizing Memorial Hermann – Texas Medical Center. Mutual commitments include administrative appointments and sharing of certain operational and research costs. Expenses for obligations to the University for the nine-month periods ended March 31, 2018 and 2017 totaled $229,679,000 and $184,089,000, respectively. This agreement expires on October 15, 2019, with automatic renewals for ten consecutive one-year terms, unless otherwise terminated by Memorial Hermann – Texas Medical Center or the University at least three years prior to the expiration date. The parties are in active discussions to establish a long-term extension to this academic and clinical affiliation agreement.

11. Impact of Hurricane Harvey

On August 24, 2017, Hurricane Harvey made landfall on the Southeast coast of Texas, which included many of the service areas where the Health System owns and operates its facilities. Widespread flooding occurred over several days in Houston and the surrounding area. The Health System temporarily evacuated one of its acute care facilities for several days and closed some of its smaller physician and ambulatory locations. All other Health System hospitals remained open throughout the period; however, certain services at all Health System hospitals were disrupted or cancelled, including elective admissions and surgeries. The hospitals subsequently returned to normal operations.

The Health System maintains insurance policies covering property damage, business interruption, and related costs, subject to applicable deductibles. Further, recovery of certain losses and costs may be provided by the Federal Emergency Management Agency (FEMA). Management is continuing to evaluate potential recoveries and file claims under existing

11. Impact of Hurricane Harvey (continued)

insurance policies and FEMA. As of March 31, 2018, the Health System has incurred net expenses of approximately $18,000,000 related to Harvey.

Key Statistical Indicators

Memorial Hermann Health System
Key Statistical Indicators
For Period Ending March 31, 2018

Current Period Current	Current Period Prior	Current Period Budget	Current Period O/(U)		Year To Date Current	Year To Date Prior	Year To Date Budget	Year To Date O/(U)
				Inpatient				
15,114	14,414	14,498	616	Admissions	129,906	124,375	126,932	2,974
77,207	76,558	76,422	785	Patient Days	689,286	674,963	666,240	23,046
31,620	29,810	29,784	6.2%	Adjusted Admissions	265,581	250,002	258,460	2.8%
161,526	158,333	157,003	2.9%	Adjusted Patient Days	1,409,183	1,356,723	1,356,599	3.9%
1,964	2,016	2,156	(192)	Deliveries	18,843	18,729	19,678	(835)
4,147	4,133	4,378	(231)	Inpatient Surgeries	36,302	36,871	37,958	(1,656)
5.11	5.31	5.27	(3.1%)	Average Length of Stay	5.31	5.43	5.25	1.1%
1.7851	1.7526	1.6944	5.4%	Case Mix Index - Total	1.7597	1.6937	1.6997	3.5%
2.0511	2.0024	1.9377	5.9%	Case Mix Index - Medicare Acute	2.0066	1.9475	1.9532	2.7%
2.86	3.03	3.11	(8.0%)	CMI Adj Avg Length of Stay	3.02	3.20	3.09	(2.4%)
				Outpatient				
6,642	6,533	6,192	450	Observation Days	57,958	55,233	54,323	3,635
5,701	5,506	4,476	1,225	Observation Patient Count	48,939	48,618	40,024	8,915
58,512	55,054	58,195	317	Emergency Visits	516,236	472,514	496,611	19,625
10,562	10,809	10,584	(22)	Outpatient Surgeries	92,534	90,487	95,848	(3,314)
135,766	134,170	127,113	8,653	Diag/Ther Registrations	1,119,303	1,090,401	1,099,226	20,077
				Productivity/Cost Efficiency				
24,236	25,158	24,767	(531)	Paid Full Time Equivalents	24,400	24,401	24,682	(282)
4.7	4.9	4.9	(4.1%)	FTE per Adj Occ Beds	4.7	4.9	5.0	(6.0%)
43.4	44.7	43.5		Labor Cost as a % of NOR	44.1	45.1	44.1	
17.8	16.8	17.1		Supply Cost as a % of NOR	17.5	16.9	17.0	

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