Texas Health Resources

Consolidated Financial Statements

December 31, 2016 and 2015

(With Independent Auditors' Report Thereon)

KPMG LLP
Suite 1400
2323 Ross Avenue
Dallas, TX 75201-2721

Independent Auditors' Report

The Board of Trustees,
Texas Health Resources:

We have audited the accompanying consolidated financial statements of Texas Health Resources, a Texas non-profit corporation, which comprise the consolidated balance sheets as of December 31, 2016 and 2015, and the related consolidated statements of operations and changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

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

KPMG LLP

Dallas, Texas
April 14, 2017

TEXAS HEALTH RESOURCES
CONSOLIDATED BALANCE SHEETS
December 31, 2016 and 2015
(Dollars in Thousands)

	2016	2015
Assets		
Current Assets:		
Cash and cash equivalents	$ 501,826	$ 463,079
Short-term investments	6,250	1,447
Receivables -		
Patient, less allowance for doubtful accounts of $173,769 in 2016 and $107,776 in 2015	495,667	439,611
Other, net	62,925	65,627
Assets limited as to use	353,161	292,579
Other current assets	147,614	114,626
Total current assets	1,567,443	1,376,969
Assets Limited as to Use	3,945,898	3,574,793
Property and Equipment, net	2,007,745	1,807,449
Investments in Unconsolidated Affiliates	224,500	210,718
Goodwill and Intangible Assets, net	153,816	158,461
Other Assets, net	85,302	46,751
Total assets	$ 7,984,704	$ 7,175,141
Liabilities and Net Assets		
Current Liabilities:		
Current portion of long-term debt	$ 268,628	$ 269,849
Accounts payable	262,885	169,499
Estimated third-party payor settlements	29,971	31,193
Accrued salaries, wages, and employee benefits	231,387	202,300
Other accrued liabilities	160,655	151,549
Total current liabilities	953,526	824,390
Long-Term Debt, net of current portion	1,719,571	1,545,218
Other Noncurrent Liabilities	46,092	79,543
Total liabilities	2,719,189	2,449,151
Net Assets:		
Net Assets of THR:		
Unrestricted	4,993,413	4,470,386
Temporarily restricted	91,762	84,737
Permanently restricted	69,643	68,867
Total net assets of THR	5,154,818	4,623,990
Non-controlling ownership interest in equity of consolidated affiliates - unrestricted	110,697	102,000
Total net assets	5,265,515	4,725,990
Total liabilities and net assets	$ 7,984,704	$ 7,175,141

See accompanying notes to the consolidated financial statements.

TEXAS HEALTH RESOURCES
CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS
December 31, 2016 and 2015
(Dollars in Thousands)

	2016	2015
Operating Revenue:		
Net patient service revenue before provision for bad debts	$ 4,637,812	$ 4,274,765
Less: Provision for bad debts	337,265	241,605
Net patient service revenue	4,300,547	4,033,160
Equity in earnings of unconsolidated affiliates	60,971	67,541
Other operating revenue	160,491	160,091
Total operating revenue	4,522,009	4,260,792
Operating Expenses:		
Salaries, wages, and employee benefits	2,249,804	2,127,464
Supplies	720,848	664,194
Other operating expenses	903,651	831,635
Depreciation and amortization	224,263	220,277
Interest expense	84,373	78,610
Total operating expenses	4,182,939	3,922,180
Operating Income	339,070	338,612
Nonoperating Gains (Losses):		
Net realized investment income and gains	101,130	132,090
Net unrealized gains (losses) on investments	167,494	(159,046)
Equity in earnings (losses) of unconsolidated affiliates, nonoperating	(1,007)	1,234
Gain (loss) on extinguishment of long-term debt	1,057	(487)
Other, net	1,065	2,505
Total nonoperating gains (losses), net	269,739	(23,704)
Revenue and Gains In Excess of Expenses and Losses before Income Taxes	608,809	314,908
Less: Income Tax Expense	3,606	4,608
Revenue and Gains In Excess of Expenses and Losses	605,203	310,300
Less: Revenue and Gains in Excess of Expenses and Losses Attributable to Non-Controlling Interest	83,284	67,306
Revenue and Gains In Excess of Expenses and Losses from Continuing Operations Attributable to THR	521,919	242,994

(Continued)

See accompanying notes to the consolidated financial statements.

TEXAS HEALTH RESOURCES
CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS
December 31, 2016 and 2015
(Dollars in Thousands)

	2016	2015
Other Changes in Unrestricted Net Assets:		
Net unrealized losses on investments, other than trading securities	$ (4,914)	$ (7,340)
Net assets released from restrictions used for purchase of property and equipment	5,592	5,617
Change in fair value of interest rate swap agreements	768	77
Other changes, net	(338)	(1,320)
Increase in Unrestricted Net Assets	523,027	240,028
Changes in Temporarily Restricted Net Assets:		
Contributions received for purchase of property and equipment	435	1,424
Contributions received for operations	18,094	10,421
Net realized investment gain	1,492	2,490
Net unrealized gains (losses) on investments	2,844	(5,508)
Change in value of split-interest agreement	(27)	(225)
Net assets released from restrictions	(15,813)	(22,486)
Increase (Decrease) in Temporarily Restricted Net Assets	7,025	(13,884)
Changes in Permanently Restricted Net Assets:		
Contributions	329	58
Net realized investment gain	525	53
Unrealized investment losses on beneficial interest in perpetual trust, net	(78)	(736)
Increase (Decrease) in Permanently Restricted Net Assets	776	(625)
Increase in Net Assets of THR	530,828	225,519
Net Assets of THR, beginning of year	4,623,990	4,398,471
Net Assets of THR, end of year	$ 5,154,818	$ 4,623,990

See accompanying notes to the consolidated financial statements.

TEXAS HEALTH RESOURCES
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years ended December 31, 2016 and 2015
(Dollars in Thousands)

	2016	2015
Cash Flows From Operating Activities:		
Increase in net assets of THR	$ 530,828	$ 225,519
Adjustments to reconcile increase in net assets to net cash provided by operating activities, excluding the net effects of acquisitions -		
(Gain) loss on extinguishment of long-term debt	(1,057)	487
Settlement of interest rate swap agreement	1,031	-
Net unrealized (gains) losses on investments	(165,346)	172,630
Net realized gains on investments	(40,600)	(76,035)
Change in value of split-interest agreement	27	225
Provision for bad debts	340,567	241,809
Restricted contributions received for purchase of property and equipment	(435)	(1,424)
Depreciation and amortization	224,263	220,277
Amortization of bond premiums/discounts and debt issuance costs	(993)	(813)
Net losses on impairment and disposal of property and equipment	2,219	2,647
Equity in earnings of unconsolidated affiliates	(60,971)	(67,541)
Distributions from unconsolidated affiliates	61,048	51,193
Equity in (earnings) losses of unconsolidated affiliates, nonoperating	1,007	(1,234)
Change in fair value of interest rate swap agreements	(670)	(1,700)
Revenue and gains in excess of expenses and losses attributable to non-controlling interest	83,284	67,306
(Increase) decrease in:		
Receivables, patient, net	(393,321)	(277,395)
Receivables, other, net	(600)	36,482
Other assets, net	(71,747)	(9,524)
Increase (Decrease) in:		
Accounts payable and accrued liabilities	124,988	(36,230)
Other noncurrent liabilities	(32,900)	(7,623)
Net cash provided by operating activities	600,622	539,056

(Continued)

See accompanying notes to the consolidated financial statements.

TEXAS HEALTH RESOURCES
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years ended December 31, 2016 and 2015
(Dollars in Thousands)

	2016	2015
Cash Flows From Investing Activities:		
Purchases of property and equipment, net	$ (423,135)	$ (234,172)
Proceeds from disposal of property and equipment	3,490	923
Cash used to acquire physician practices and other consolidated affiliates	(2,073)	(4,381)
Investment in unconsolidated affiliates, net	(14,866)	(6,984)
Purchases of short-term investments and assets limited as to use, net	(230,571)	(553,250)
Net cash used in investing activities	(667,155)	(797,864)
Cash Flows From Financing Activities:		
Proceeds from issuance of long-term debt	751,022	584,212
Debt issuance costs	(5,127)	(4,391)
Principal payments on capital lease obligations	(809)	(1,242)
Principal payments on long-term debt	(43,617)	(38,450)
Redemption of long-term debt	(520,499)	(211,618)
Settlement of interest rate swap agreement	(1,031)	(3,911)
Contributions from non-controlling interest holders	3,380	4,933
Distributions to non-controlling interest holders	(78,474)	(62,643)
Proceeds from restricted contributions received for purchase of property and equipment	435	1,424
Net cash provided by financing activities	105,280	268,314
Net Increase in Cash and Cash Equivalents	38,747	9,506
Cash and Cash Equivalents, beginning of year	463,079	453,573
Cash and Cash Equivalents, end of year	$ 501,826	$ 463,079
Supplemental Disclosure of Cash Flow Information:		
Cash paid for interest	$ 91,129	$ 78,642
Cash paid for income taxes	$ 4,289	$ 4,327
Supplemental Schedule of Noncash Financing Activities:		
Property and equipment acquired through capital lease obligations	$ 207	$ 778

See accompanying notes to the consolidated financial statements.

1. Organization

Texas Health Resources (THR), a Texas non-profit corporation, operates through its controlled affiliates a health care system with services and facilities throughout north central Texas. THR is organized and operated for the benefit of its tax-exempt controlled affiliates and has been recognized by the Internal Revenue Service (IRS) as exempt from federal income taxes under Section 501(a) of the Internal Revenue Code of 1986, as amended (the Code), as an organization described in Section 501(c)(3). THR's wholly-controlled facilities include 13 acute care hospitals and a 10-bed long-term care hospital. The following table provides the locations of THR's tax-exempt member hospitals (the Tax-Exempt Hospitals) as of December 31, 2016. The Tax-Exempt Hospitals have been recognized as exempt from federal income taxes under the Code as organizations described in Section 501(c)(3).

Tax-Exempt Hospital	Location (Texas)
Texas Health Arlington Memorial Hospital	Arlington
Texas Health Harris Methodist Hospital Alliance	Fort Worth
Texas Health Harris Methodist Hospital Azle	Azle
Texas Health Harris Methodist Hospital Cleburne	Cleburne
Texas Health Harris Methodist Hospital Fort Worth	Fort Worth
Texas Health Harris Methodist Hospital Hurst-Euless-Bedford	Bedford
Texas Health Harris Methodist Hospital Southwest Fort Worth	Fort Worth
(with second location at Texas Health Hospital Clearfork)	Fort Worth
Texas Health Harris Methodist Hospital Stephenville	Stephenville
Texas Health Presbyterian Hospital Allen	Allen
Texas Health Presbyterian Hospital Dallas	Dallas
Texas Health Presbyterian Hospital Denton	Denton
Texas Health Presbyterian Hospital Kaufman	Kaufman
Texas Health Presbyterian Hospital Plano	Plano
Texas Health Specialty Hospital Fort Worth (10-bed long-term care hospital)	Fort Worth

In addition, THR is the sole member or sole shareholder of certain other wholly-controlled affiliates engaged in health care related activities in support of its mission including Texas Health Physicians Group (THPG), a Texas non-profit organization certified by the Texas Medical Board pursuant to Section 162.001(b) of the Texas Occupations Code and recognized as exempt from federal income taxes under the Code as an organization described in Section 501(c)(3) that consists of approximately 900 employed physicians and mid-level providers in 225 locations throughout north central Texas.

1. Organization, continued

THR and some of its controlled affiliates participate in joint ventures with physicians and non-physicians to operate hospitals and other health related ventures. The following table provides the location of the joint venture hospitals along with THR's ownership interest in those hospitals at December 31, 2016.

Hospital	Location (Texas)	Ownership Interest
Consolidated:		
Texas Institute for Surgery, L.L.P. (d/b/a Texas Institute for Surgery at Texas Health Presbyterian Hospital Dallas)	Dallas	50.0%
Physicians Medical Center, L.L.C. (d/b/a Texas Health Center for Diagnostics & Surgery Plano)	Plano	53.1%
Southlake Specialty Hospital, L.L.C. (d/b/a Texas Health Harris Methodist Hospital Southlake)	Southlake	53.9%
Rockwall Regional Hospital L.L.C. (d/b/a Texas Health Presbyterian Hospital Rockwall)	Rockwall	61.0%
Flower Mound Hospital Partners, L.L.C. (d/b/a Texas Health Presbyterian Hospital Flower Mound)	Flower Mound	53.5%
AMH Cath Labs, L.L.C. (d/b/a Texas Health Heart & Vascular Hospital Arlington)	Arlington	54.0%
Unconsolidated:		
USMD Hospital of Arlington, L.P.	Arlington	51.0%
USMD Hospital of Fort Worth, L.P.	Fort Worth	51.0%
Texas Health Huguley, Inc. (d/b/a Texas Health Huguley Hospital Fort Worth South)	Fort Worth	51.0%
Texas Rehabilitation Hospital of Fort Worth, L.L.C.	Fort Worth	30.0%
Texas Rehabilitation Hospital of Arlington, L.L.C.	Arlington	30.0%
Texas Health Hospital (in Carrollton)	Carrollton	51.0%

In addition to the hospitals listed above, there are numerous other non-hospital health related joint ventures included in THR's accompanying consolidated financial statements, including outpatient imaging and surgery centers and free-standing emergency rooms.

THR and its tax-exempt controlled affiliates receive support from the Texas Health Resources Foundation (Foundation). The Foundation operates as a non-private foundation exempt from federal income taxes under Section 501(a) of the Code as an organization described in Section 501(c)(3), and THR is the sole corporate member.

The accompanying consolidated financial statements include the accounts of THR, the Foundation, its wholly controlled affiliates and its consolidated joint ventures (collectively, the System). All significant intercompany accounts and transactions have been eliminated in the accompanying consolidated financial statements.

2. Summary of Significant Accounting Policies

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents include cash, money market funds, and governmental or other securities with original maturities of three months or less at time of purchase, excluding amounts limited as to use by board designation or other arrangements. THR's cash management system provides for daily investment of available balances and the funding of outstanding checks when presented for payment. Outstanding, but unpresented, checks totaling approximately $29,594,000 and $23,272,000 at December 31, 2016 and 2015, respectively, have been included in accounts payable in the accompanying consolidated balance sheets. Upon presentation for payment, these checks are funded through available cash or cash equivalent balances. The change in outstanding but unpresented checks is included in cash used in operating activities on the accompanying consolidated statements of cash flows.

Investments and Investment Income

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the consolidated balance sheets. Realized investment income or loss (including realized gains and losses on investments, interest, and dividends) is included in revenue and gains in excess of expenses and losses unless the income or loss is restricted by donor or law. Investments in mineral interests, which have limited marketability, are stated at fair value, as estimated based on a multiple of annual revenues. Investments in real estate are stated at fair value, as estimated by private valuations. Investments in hedge funds are stated at fair value, as estimated by the general partner of the hedge fund and reviewed by management. Unrealized gains and losses on investments are excluded from revenue and gains in excess of expenses and losses unless the investments are trading securities. Management reviews individual securities to determine whether a decline in fair value below the amortized cost basis is other than temporary. If the decline in fair value is judged to be other than temporary, the cost basis of the individual security is written down to fair value as a new cost basis and the amount of the write-down is included in realized investment gains or losses in the consolidated statements of operations and changes in net assets. To determine whether a decline is other than temporary, management considers whether it has the ability and intent to hold the investment until a market price recovery, which may be maturity, and whether evidence indicating the cost of the investment is recoverable outweighs evidence to the contrary.

The System invests in various securities. Investment securities, in general, are exposed to various risks, such as interest rate, credit, and overall market volatility risks. Due to the level of risk associated with certain investment securities, it is reasonable to assume that changes in the values of investment securities will occur in the near term and that such changes could be material to the accompanying consolidated financial statements.

Split-Interest Agreements

The System has received as contributions various types of split-interest agreements, including charitable gift annuities, charitable remainder unitrusts and perpetual trusts held by a third party.

2. Summary of Significant Accounting Policies, continued

Split-Interest Agreements, *continued*

Under charitable gift annuity arrangements for which the System is the trustee of the assets, the System records the assets at fair value and the liabilities to the beneficiaries at the present value of the estimated future payments to be distributed by the System to such beneficiaries. The amount of the contribution is the difference between the asset and the liability and is recorded as unrestricted revenue, unless otherwise restricted by the donor. Subsequent changes to the annuity liability are recorded as changes in value of split-interest agreements in the appropriate net asset class.

Under charitable remainder unitrust arrangements for which the System is the trustee of the assets, the System records as donor-restricted contributions the present value of the residual interest in the trust in the period in which the trust is established. The assets held in trust are recorded at fair value when received, and the liabilities to the beneficiaries are recorded at the present value of the estimated future payments to be distributed by the System to such beneficiaries. The amount of the contribution is the difference between the asset and the liability and is recorded as temporarily restricted or permanently restricted support. Subsequent changes in fair value for charitable remainder unitrusts are recorded as changes in value of split-interest agreements in the appropriate net asset class.

Under perpetual trusts held by a third-party arrangement, the System records contribution revenue and an asset when it is notified of the trust's existence. The fair value of the contribution is measured at the present value of the estimated future cash receipts from the trust's assets and that value may generally be measured by the fair value of the assets contributed to the trust, unless facts and circumstances indicate that the fair value of the assets contributed to the trust differs from the present value of the expected future cash flows. Distributions from the trust are reported as investment income that increases the appropriate net asset class. Adjustments to the amount reported as an asset, based on periodic review, are recognized as unrealized investment gains or losses on beneficial interest in perpetual trust in the permanently restricted net asset class.

Under the charitable gift annuity arrangements and charitable remainder unitrust arrangements for which the System is not the trustee of the assets, the System records a receivable and contribution revenue at the present value of the estimated future distributions expected to be received by the System over the expected term of the agreement. However, if an unrelated third-party has variance power to redirect the benefits to another organization or if the System's rights to the benefits are conditional, the System does not recognize its potential for future distributions from the asset held by the trustee.

The discount rates and actuarial assumptions used in calculating present values have been based on Internal Revenue Service guidelines and actuarial tables. For agreements in which the System is the trustee, the discount rates used are commensurate with the risks involved at the time the contributions are initially recognized and are not subsequently revised. For agreements in which the System is not the trustee, under Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 958-30, *Not-for-Profit Entities Split Interest Agreements*, and the guidance as provided in the *AICPA Audit and Accounting Guide*, *Not-for-Profit Organizations*, split-interest agreements held by others net expected cash flows are revalued to fair value at each year-end using a current risk-free rate of return, which ranged from 1.93% to 3.06% and 1.76% to 3.01% for the years ended December 31, 2016 and 2015, respectively.

2. Summary of Significant Accounting Policies, continued

Accounts Receivable and Allowance for Doubtful Accounts

Patient accounts receivable are reported net of estimated allowances for doubtful accounts and contractual adjustments in the balance sheets. The allowance and resulting provision for bad debts is based upon a combination of the aging of receivables and management's assessment of historical and expected net collections considering business and economic conditions, trends in health care coverage and other collection indicators for each of its major payor sources of revenue. Management assesses the adequacy of the allowance for doubtful accounts based upon historical write-off experience and payment trends by payor category. Patient accounts are also monitored and, if necessary, past due accounts are placed with collection agencies in accordance with guidelines established by management. For receivables associated with services provided to patients who have third-party coverage, the System analyzes contractually due amounts and provides an allowance for doubtful accounts and a provision for bad debts, if necessary (for example, for expected uncollectible deductibles and copayments, or for payors who are known to be having financial difficulties that make the realization of amounts due unlikely). For receivables associated with self-pay patients (which includes both patients without insurance and patients with deductible and copayment balances due for which third-party coverage exists for part of the bill), the System records a significant provision for bad debts in the period of service on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between the billed rates and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for doubtful accounts.

The System's allowance for doubtful accounts for self-pay patients (including allowances for charity care) increased from 96.1% of self-pay accounts receivable at December 31, 2015 to 97.7% of self-pay accounts receivable at December 31, 2016. In addition, the System's self-pay write-offs for bad debts increased from approximately $250,000,000 for fiscal year 2015 to approximately $306,000,000 for fiscal year 2016. The increase in write offs was the result of an increase in overall revenue and uninsured patients in fiscal year 2016. The System does not maintain a material allowance for doubtful accounts from third-party payors, nor did it have significant write-offs from third-party payors.

Assets Limited as to Use

The System maintains certain assets that are limited as to use under board designation, indenture agreements, donor restriction, and other provisions. Amounts required to fund current liabilities of the System have been classified as current assets in the consolidated balance sheets.

Property and Equipment

Property and equipment acquisitions are recorded at cost. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method. Equipment under capital lease obligations is amortized on the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. Such amortization is included in depreciation and amortization in the consolidated statements of operations and changes in net assets. Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets.

2. Summary of Significant Accounting Policies, continued

Property and Equipment, continued

Gifts of long-lived assets such as land, buildings, or equipment are reported as unrestricted support and are excluded from revenue and gains in excess of expenses and losses unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

Goodwill and Intangible Assets

Goodwill is an asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognized. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized. The System reviews goodwill annually, or more frequently if circumstances warrant a more timely review, to determine if there has been an impairment. FASB ASC Topic 350, *Intangibles—Goodwill and Other* (Topic 350), provides an entity the option to first assess qualitative factors to determine whether the existence of events or circumstances indicates that it is more likely than not that the fair value of a reporting unit is less than its carrying amount or that indefinite-lived assets are impaired. If, after assessing the totality of events and circumstances, an entity determines it is not more likely than not that the fair value of the reporting unit is less than its carrying amount or that the indefinite-lived intangible asset is impaired, then the entity is not required to take further action. However, if an entity concludes otherwise, then it is required to perform the two-step goodwill impairment test described in Topic 350 or determine the fair value of the indefinite-lived intangible asset and perform a quantitative impairment test by comparing the fair value with the carrying amount. During fiscal years ended December 31, 2016 and 2015, the System prepared a qualitative assessment of goodwill and indefinite-lived intangible assets impairment for all reporting units that have assigned goodwill and indefinite-lived intangible assets, and no impairments were identified.

Effective January 1, 2015, one of the System's consolidated joint ventures, Health Imaging Partners, LLC (HIP) adopted FASB Accounting Standards Update (ASU) 2014-02, *Intangibles—Goodwill and Other (Topic 350): Accounting for Goodwill, a consensus of the Private Company Council*, and began amortizing their existing goodwill on a straight-line basis over 10 years.

Goodwill activity for the years ended December 31, 2016 and 2015 is presented below (dollars in thousands):

	2016	2015
Balance at beginning of year	$ 149,631	$ 151,262
Goodwill acquired from purchases of consolidated affiliates and/or physician practices	-	2,349
Amortization of goodwill - consolidated joint venture	(4,002)	(3,980)
Balance at end of year	$ 145,629	$ 149,631

2. Summary of Significant Accounting Policies, continued

Asset Retirement Obligations

The fair value of a liability for a legal obligation associated with the retirement of long-lived assets is recognized in the period in which it is incurred if the fair value can be reasonably estimated. The fair value, which approximates the cost a third party would incur in performing the tasks necessary to retire such assets, is recognized at the present value of expected future cash flows and is added to the carrying value of the associated asset and depreciated over the asset's useful life. The liability is accreted over time and is reduced upon settlement of the obligation.

Impairment or Disposal of Long-Lived Assets

When events or changes in circumstances indicate that the carrying amount of long-lived assets, including property and equipment, or other long-lived assets, may not be recoverable, an evaluation of the recoverability of currently recorded costs is performed. When an evaluation is performed, the estimated value of undiscounted future net cash flows associated with the assets is compared to the assets' carrying value to determine if a write-down to fair value is required.

If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Long-lived assets to be disposed of are reflected at the lower of either their carrying amounts or their fair value less costs to sell or close. In such circumstances, estimates of fair value are based on independent appraisals, established market prices for comparable assets, or internal calculations of estimated discounted future cash flows.

Derivative Instruments

Certain consolidated joint ventures, Rockwall Regional Hospital, L.L.C. (Rockwall), Flower Mound Hospital Partners, L.L.C. (Flower Mound) and AMH Cath Labs, L.L.C. (ACL), use interest rate swap agreements to manage interest rate risk associated with their floating rate borrowings and account for derivative instruments utilized in connection with these activities in accordance with FASB ASC Topic 815, *Derivatives and Hedging,* which requires entities to recognize all derivative instruments as either assets or liabilities in the consolidated balance sheets at their respective fair values.

These consolidated joint ventures designate and account for their interest rate swap agreements as cash flow hedges in accordance with FASB ASC Subtopic 815-30, *Derivatives and Hedging – Cash Flow Hedges.* For all hedging relationships, these consolidated joint ventures formally document the hedging relationship and its risk management objective and strategy for undertaking the hedge, the hedging instrument, the hedged item, the nature of the risk being hedged, how the hedging instrument's effectiveness in offsetting the hedged risk will be assessed prospectively and retrospectively, and a description of the method of measuring ineffectiveness. These consolidated joint ventures also formally assess, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in the hedging transactions are highly effective in offsetting cash flows of hedged items. For derivative instruments that are designated and qualify as a cash flow hedge, the effective portion of the gain or loss on the derivative is reported as other changes in unrestricted net assets and reclassified into earnings in the same period or periods during which earnings are affected by the variability in cash flows of the designated hedged item. Gains and losses on the derivative representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in revenues and gains in excess of expenses and losses.

These consolidated joint ventures discontinue hedge accounting prospectively when it is determined that the derivative is no longer effective in offsetting cash flows of the hedged item, the derivative expires or is sold, terminated, or exercised, or the derivative designation is removed.

2. Summary of Significant Accounting Policies, continued

Derivative Instruments, *continued*

In all situations in which hedge accounting is discontinued and the derivative is retained and not redesignated as part of a new hedging relationship, these consolidated joint ventures continue to carry the derivative at its fair value in the consolidated balance sheets and recognize any subsequent changes in its fair value in revenues and gains in excess of expenses and losses. When it is probable that a forecasted transaction will not occur, these consolidated joint ventures discontinue hedge accounting and recognize immediately any gains and losses that were accumulated in other changes in unrestricted net assets.

By using derivative financial instruments to hedge exposures to changes in interest rates, the System exposes itself to credit risk and market risk. Credit risk is the failure of the counterparty to perform under the terms of the derivative contract. When the fair value of a derivative contract is positive, the counterparty owes the System, which creates credit risk for the System. When the fair value of a derivative contract is negative, the System owes the counterparty and, therefore, the System is not exposed to the counterparty's credit risk in these circumstances. The System minimizes counterparty credit risk in derivative instruments by entering into transactions with high-quality counterparties. The derivative instruments entered into by the System do not contain credit-risk-related contingent features.

Market risk is the adverse effect on the value of a derivative instrument that results from a change in interest rates. The market risk associated with interest-rate contracts is managed by establishing and monitoring parameters that limit the types and degree of market risk that may be undertaken.

Physician Income Guarantees

Consistent with its policy on physician relocation and recruitment, THR hospitals provide income guarantee agreements to certain non-employed physicians who agree to relocate to its communities to fill a need in the hospital's service area and commit to remain in practice there. Under such agreements, THR hospitals are required to make payments to the physicians in excess of the amounts they earn in their practice up to the amount of the income guarantee. The income guarantee periods are typically 12 months, but are occasionally negotiated for longer periods of time if obstacles to the physician's startup are anticipated. Such payments plus interest are recoverable from the physicians if they do not fulfill their obligation to practice full-time in the community and maintain active privileges at the recruiting hospital for typically three years subsequent to the guarantee period. At December 31, 2016, the maximum potential amount of future payments under these guarantees was approximately $8,468,000.

At December 31, 2016 and 2015, THR had a liability of approximately $3,098,000 and $3,245,000, respectively, for the fair value of guarantees entered into, with a corresponding asset recorded in other current assets in the consolidated balance sheets, which will be amortized over the commitment period.

Donor-Restricted Gifts

Unconditional promises to give cash and other assets to THR and its tax-exempt controlled affiliates are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the accompanying consolidated statements of operations and changes in net assets as net assets released from restrictions and other operating revenue.

2. Summary of Significant Accounting Policies, continued

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by THR and its tax-exempt controlled affiliates have been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by THR and its tax-exempt controlled affiliates in perpetuity.

Revenue and Gains in Excess of Expenses and Losses

The consolidated statements of operations and changes in net assets include revenue and gains in excess of expenses and losses. Changes in unrestricted net assets which are excluded from revenue and gains in excess of expenses and losses, consistent with industry practice, include unrealized gains and losses on investments other than trading securities, permanent transfers of assets to and from affiliates for other than goods and services, contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purposes of acquiring such assets), and other items required by GAAP to be reported separately.

Net Patient Service Revenue

Net patient service revenue is recognized as services are provided and reported at the estimated net realizable amounts from patients, third-party payors and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. 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.

Charity Care

The Tax-Exempt Hospitals and THPG provide care to patients who meet criteria established under THR's financial assistance policy without charge or at amounts less than their established rates. The consolidated joint venture hospitals and healthcare entities have similar financial assistance policies, or have adopted the THR financial assistance policy. Because the System does not pursue collection of amounts determined to qualify as charity care, those amounts are not reported as net patient service revenue or patient receivables.

Electronic Health Record Incentive Payment Program

The American Recovery and Reinvestment Act of 2009 (the Act) established incentive payments under the Medicare and Medicaid programs for hospitals that meaningfully use certified electronic health record (EHR) technology. In order to qualify for the Act's reporting period, a hospital is required to meet certain designated EHR meaningful use criteria from both mandatory and optionally selected requirements within the Act's reporting year. The System has elected to apply the grant accounting model whereby incentive payments are recognized as income when there is reasonable assurance that the entity will successfully demonstrate compliance with the minimum number of meaningful use objectives. The System's management believes the relevant criteria were met or are being met for Years One through Five reporting and determined compliance was reasonably assured.

2. Summary of Significant Accounting Policies, continued

Electronic Health Record Incentive Payment Program, *continued*

The System's eligible hospitals recognized revenue of approximately $1,344,000 and $1,110,000 in 2016 and 2015, respectively, under the Act's Years One through Five reporting periods, which was recorded as other operating revenue in the accompanying consolidated statements of operations and changes in net assets. This recognized revenue includes accruals for EHR meaningful use of approximately $232,000 and $1,295,000 at December 31, 2016 and 2015, respectively, which are included in other receivables in the accompanying consolidated balance sheets. Of the reimbursement payments received by the System's eligible hospitals since the program began, approximately $4,838,000 and $5,216,000 at December 31, 2016 and 2015, respectively, have been recorded as reserves for potential adjustments in estimated third party payor settlements in the accompanying consolidated balance sheets.

Self-Insurance

Under THR's self-insurance programs, claims are reflected as liabilities based upon actuarial estimation, including both reported, and incurred but not reported claims, taking into consideration the severity of the incidents and the expected timing of claim payments.

Recent Accounting Pronouncements

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*, which affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of non-financial assets unless those contracts are within the scope of other standards. The core principle of the guidance in this ASU 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 currently evaluating all of the provisions of the ASU, which are effective for THR beginning January 1, 2018, as amended by ASU 2015-14. The FASB has issued additional guidance subsequent to ASU 2015-14 pertaining to this topic. The additional guidance has not changed the effective date as of the date of issuance of the consolidated financial statements and will be adopted in conjunction with ASU 2014-09.

In February 2015, the FASB issued ASU 2015-02, *Consolidation (Topic 810): Amendments to the Consolidation Analysis*, which intended to improve targeted areas of consolidation guidance for legal entities such as limited partnerships, limited liability corporations, and securitization structures (collateralized debt obligations, collateralized loan obligations, and mortgage-backed security transactions). The provisions of this ASU were effective for THR beginning January 1, 2016, and adoption did not have a material impact on the consolidated financial statements.

In April 2015, the FASB issued ASU 2015-03, *Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs*, which intended to simplify the presentation of debt issuance costs. The amendments required that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of the related debt liability, consistent with debt discounts. The provisions of this ASU were effective for THR beginning January 1, 2016, and resulted in THR moving debt issuance costs from other long-term assets to long term debt, and the related balances at December 31, 2015 have been restated to comply with the current provisions.

2. Summary of Significant Accounting Policies, continued

Recent Accounting Pronouncements, continued

In July 2015, the FASB issued ASU 2015-11, *Simplifying the Measurement of Inventory*, which requires an entity to measure inventory at the lower of cost or net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion and transportation. The amendments do not apply to inventory that is measured using last-in, first-out (LIFO) or the retail inventory method. The amendments apply to all other inventory, which includes inventory that is measured using first-in, first-out (FIFO) or average cost. Management has evaluated all of the provisions of this ASU, which is effective for THR beginning January 1, 2017, and adoption is not expected to have a material impact on the consolidated financial statements.

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*, which makes targeted improvements to the measurement and disclosure of financial assets and financial liabilities, especially equity investments and other financial instruments, liabilities resulting from instrument-specific credit risk, and valuation allowances for deferred tax assets. Management has evaluated all of the provisions of this ASU, which is effective for THR beginning January 1, 2018, and adoption is not expected to have a material impact on the consolidated financial statements

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), which significantly modifies the treatment of leases requiring lessees to recognize most leases on the balance sheet. In addition, while the new standard retains most of the principles of the existing lessor model, it aligns many of those principles with the FASB's new revenue guidance (ASU 2014-09). Management has not yet evaluated all of the provisions of this ASU, which is effective for THR beginning January 1, 2019, but adoption is expected to materially increase assets and liabilities in the consolidated financial statements.

In August 2016, the FASB issued ASU 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*, which requires not-for-profit entities to report two classes of net assets, as well as enhances disclosures on board designated funds, liquidity, and functional expenses. Management has not yet evaluated all of the provisions of this ASU, which is effective for THR beginning January 1, 2018.

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*, which provides cash flow statement classification guidance. Management has not yet evaluated all of the provisions of this ASU, which is effective for THR beginning January 1, 2018.

Reclassifications

Certain reclassifications have been made to the December 31, 2015 financial statements to conform to the December 31, 2016 presentation. The reclassifications had no effect on revenue and gains in excess of expenses and losses or net assets as previously reported. Previously, deferred financing costs were required to be presented in the balance sheet as an asset. As a result of adopting FASB ASU 2015-03, all costs incurred to issue debt are now presented in the consolidated balance sheet as a component of long-term debt, and the amortization of debt issuance costs are now included with amortization of bond premiums and discounts as cash flows from operating activities on the consolidated statement of cash flows.

3. Net Patient Service Revenue

The System has agreements with third-party payors that provide for payments to the hospitals and THPG at amounts different from established rates. A summary of the payment arrangements with major third-party payors follows:

> ***Medicare*.** Inpatient acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Inpatient non-acute services, outpatient services, and certain capital and medical education costs related to Medicare beneficiaries are paid based on a combination of prospective and cost reimbursement methodologies or fee schedule. The hospitals are reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the hospitals and audits thereof by the Medicare fiscal intermediary.
>
> ***Medicaid.*** Inpatient services rendered to Medicaid program beneficiaries are reimbursed under a prospectively determined system similar to Medicare. Most outpatient services are reimbursed by the Medicaid program under a cost reimbursement methodology or fee schedule. The hospitals are reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the hospitals and audits thereof by the Medicaid fiscal intermediary.

Medicare and Medicaid cost report settlements are estimated in the period services are provided to the program beneficiaries. These estimates are revised as needed until final settlement of the cost report. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Net patient service revenue increased approximately $12,406,000 and $23,179,000 in 2016 and 2015, respectively, due to reassessment of settlement issues and other changes in estimates related to final settlements.

The System has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment to the hospitals and THPG under these arrangements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates. Items such as high cost drugs and implants are sometimes paid as an add-on to prospectively determined rates. All of these payment methods can occur independently or in combination for different commercial agreements.

Additionally, the Tax-Exempt Hospitals provide discounted pricing to uninsured patients. The pricing is calculated by applying a discount to charges for services received. The discount rate was 45% in 2016 and 2015. The consolidated and unconsolidated joint venture hospitals also provide similar discounted pricing to uninsured patients.

The System recognizes patient service revenue associated with services provided to patients who have third-party payor coverage on the basis of contractual rates for the services rendered. For uninsured patients that do not qualify for charity care, the System recognizes revenue on the basis of its standard discounted rates for services provided. On the basis of historical experience, a significant portion of the System's uninsured patients will be unable or unwilling to pay for the services provided. Thus, the System records a significant provision for bad debts and/or charity care related to uninsured patients in the period the services are provided.

3. Net Patient Service Revenue, continued

Patient service revenue, net of contractual allowances and discounts (but before the provision for bad debts), recognized in the years ended December 31, 2016 and 2015 from these major payor sources, is as follows (dollars in thousands):

	2016	2015
Medicare	$ 781,196	$ 759,693
Medicare Managed Care	459,747	419,805
Medicaid	127,722	98,958
Medicaid Managed Care	130,566	130,709
Managed Care	2,853,747	2,645,727
Commercial and Other	171,020	145,026
Private Pay	113,814	74,847
	$ 4,637,812	$ 4,274,765

4. Section 1115 Waiver

In December 2011, the federal government approved the Texas Healthcare Transformation and Quality Improvement Program: 1115 Waiver (Waiver Program), which was implemented by the Texas Health and Human Services Commission (HHSC). The Waiver Program has been extended through December 31, 2017 and provides for two pools of Medicaid supplemental funding, an uncompensated care (UC) pool and a delivery system reform incentive payment (DSRIP) pool. During 2016 and 2015, THR (through certain wholly controlled tax-exempt and joint venture hospitals) participated in UC programs in Tarrant, Dallas, Collin and Johnson counties.

During 2016 and 2015, THR, on behalf of its participating hospitals, recorded supplemental Medicaid patient service revenue of approximately $68,567,000 and $61,223,000, respectively, under the UC pool of the Waiver Program. At December 31, 2016 and 2015, THR has a receivable of approximately $11,574,000 and $17,330,000, respectively, related to the UC pool of the Waiver Program.

THR also receives other operating revenue from the DSRIP pool of the Waiver Program. The program provides for incentive revenue to be earned by facilities for initiating programs that benefit the community and lower overall healthcare cost, and for reaching preset goals for those programs. The DSRIP program is currently approved to run through the term of the Waiver. For year one, facilities who chose to participate received incentive revenue for submitting acceptable project plans that would span the five years of the program. During years two through five, providers earn revenue by meeting the program goals and reporting them to the State. THR recognized approximately $30,944,000 and $39,128,000 in DSRIP revenue in 2016 and 2015, respectively, which was recorded as other operating revenue in the accompanying consolidated statements of operations and changes in net assets. This recognized revenue includes approximately $22,666,000 and $24,142,000 at December 31, 2016 and 2015, respectively, which are included in other receivables in the accompanying consolidated balance sheets. Approximately $4,003,000 and $512,000 at December 31, 2016 and 2015, respectively, have been recorded in other accrued liabilities in the accompanying consolidated balance sheets as a reserve for possible adjustments from HHSC compliance audits.

4. Section 1115 Waiver, continued

The Centers for Medicare & Medicaid Services (CMS) has reviewed certain funding arrangements, which include some THR hospitals, under the Waiver Program and their compliance with federal provider-related donation prohibitions to determine if any financing structure within the State Medicaid program violates federal law. On June 9, 2015, CMS authorized the current private-hospital funding arrangements in Texas to continue for waiver-payment dates through August, 2017. Waiver payments made to private hospitals after that date could be at risk if agreed-to changes are not made.

Funding for both UC and DSRIP depends on the Tarrant County Hospital District and Dallas County Hospital District providing intergovernmental transfers to HHSC as the state share, which is then matched by federal funds. The public entities have the sole discretion to make or not make intergovernmental transfers. In a letter dated September 1, 2016, to HHSC, CMS disallowed federal matching funds applicable to the Dallas County and Tarrant County affiliations for the quarter ended December 31, 2015. CMS alleges that the private hospitals participating in these affiliations fail to comply with the federal provider-related donation requirements. On October 28, 2016, HHSC requested a reconsideration by the Secretary of Health & Human Services. CMS responded on December 21, 2016 stating they believe HHSC's arguments do not merit a withdrawal or revision to the disallowance. HHSC is currently evaluating a decision to appeal the disallowance to the HHS Departmental Appeals Board. It is too early to predict the outcome of this matter, including whether HHSC will prevail in the litigation and whether CMS will disallow federal matching funds to the Dallas County and Tarrant County affiliations for additional federal fiscal year quarters.

Beginning on October 1, 2015, THR has recorded deferred revenue equal to 50% of the federal portion of UC revenue. At December 31, 2016 and 2015, THR has deferred revenue of approximately $21,454,000 and $3,105,000, respectively included in other accrued liabilities on the consolidated balance sheets. The deferred revenue at December 31, 2016 and 2015 represents advances and anticipated settlements or potential adjustments of previously received funds.

5. Charity Care and Community Benefit

In accordance with its mission, the System commits substantial resources to sponsor a broad range of services for the indigent as well as the broader community. Community benefit provided to the indigent includes the cost of providing services to persons who cannot afford health care due to inadequate resources and/or to persons who are underinsured. This category of community benefit, in accordance with Texas law, includes the unreimbursed costs of traditional charity care as well as the estimated unreimbursed costs of care provided to beneficiaries of Medicaid and other indigent public programs. The System also benefits the communities it serves by providing facilities for the education and training of health care professionals and by participating in research activities that offer the potential of improving health care.

The System also promotes access to health care services by providing support for indigent care clinics; promotes community health education and wellness programs; supports other local community based non-profit organizations through charitable donations; and sponsors a variety of health-related support groups and programs. These activities are classified as community benefit under Texas law.

The System provides care to patients who meet criteria established under its financial assistance policy without charge or at amounts less than their established rates. Because the System does not pursue collection of amounts determined to qualify as charity care, they are not reported as net patient service revenue. When the System does not have the information required to properly determine charity status, the amounts owed by these individuals are classified as bad debt expense. The System estimates costs associated with charity care

5. Charity Care and Community Benefit, continued

based on the ratio of cost to gross charges and applies this ratio to charity care gross charges. The System estimates direct and indirect costs associated with providing charity care was approximately $263,980,000 and $269,304,000 for the years ended December 31, 2016 and 2015, respectively. The System receives certain funds to offset or subsidize financial assistance provided from gifts or grants restricted for charity or indigent care. The amount of such funds recognized in unrestricted operations from such sources totaled approximately $705,000 and $963,000 for the years ended December 31, 2016 and 2015, respectively.

Effective January 1, 2015, THR no longer pursues collection of certain patient accounts that fall under its presumptive charity care specifications. Previously, collections were pursued and these accounts were included in revenue with a corresponding charge to bad debts if not collected. Under the new policy, such amounts are no longer recorded as revenue which correspondingly reduces the provision for bad debts. There has not been a significant impact to net patient service revenue as a result of this policy change.

THR (through certain wholly controlled tax-exempt and joint venture hospitals), Baylor Health Care System, HCA North Texas Division, and Methodist Hospitals of Dallas have created Dallas County Indigent Care Corporation (DCICC), and Tarrant County Indigent Care Corporation (TCICC), both Texas non-profit corporations, to provide joint community benefit programs and services. DCICC has entered into agreements with The University of Texas Southwestern Medical Center (UT Southwestern) to provide professional and technical services to indigent patients in Dallas County who seek medical care at Parkland Memorial Hospital and Healthcare System facilities. TCICC has entered into agreements with various physician groups to provide professional healthcare services to indigent persons in Tarrant County who present for care at John Peter Smith Hospital and Healthcare System facilities.

In 2013, THR (through certain wholly controlled tax-exempt hospitals) began participating in similar community benefit programs in other counties. These programs include: the Johnson County Community Care Corporation (JCCCC), which has entered into contracts with healthcare providers to pay for the care of indigent county residents: Collin County, where THR has entered into a contract with Primamed Physicians Association to pay for care of indigent county residents; and Denton County to provide hospital care for indigent county residents.

During 2016 and 2015, THR, on behalf of its participating hospitals, recorded expense of approximately $51,056,000 and $47,743,000, respectively, representing disbursements made for services listed above through DCICC, TCICC, JCCCC, and Collin and Denton Counties for providing services to indigent patients.

6. Investments

Short-Term Investments

The composition of short-term investments at December 31, 2016 and 2015 is set forth in the following table (dollars in thousands):

	2016	2015
Cash and cash equivalents	$ 755	$ -
U.S. government securities	500	-
Fixed income securities	4,995	1,447
	$ 6,250	$ 1,447

6. Investments, continued

Assets Limited as to Use

Assets limited as to use that are required for obligations classified as current liabilities are included in current assets in the consolidated balance sheets. The composition of assets limited as to use at December 31, 2016 and 2015 is set forth in the following table (dollars in thousands):

	2016	2015
Internally designated:		
Cash and cash equivalents	$ 610	$ 2,623
U.S. government securities	1,188	1,179
Fixed income securities	1,334,441	1,304,448
Equity securities	2,637,266	2,309,975
Mutual funds	2,031	586
Hedge funds	-	1,347
Donor-restricted special purpose and endowment funds:		
Cash and cash equivalents	1,145	1,134
Fixed income securities	38,050	37,187
Equity securities	93,174	89,695
Mutual funds	530	-
Mineral interests	1,451	2,115
Real estate	18	18
Beneficial interest in perpetual trust, held in charitable remainder unitrusts, and held in charitable gift annuities:		
Cash and cash equivalents	297	361
Fixed income securities	1,558	2,186
Equity securities	5,717	5,077
Mutual funds	6,313	6,174
Mineral interests	599	950
Real estate	718	718
Other provisions:		
Cash and cash equivalents	104,355	42,693
Fixed income securities	45,743	38,368
Equity securities	9,968	10,217
	4,285,172	3,857,051
Less: Assets limited as to use - required for current liabilities	(353,161)	(292,579)
	$ 3,932,011	$ 3,564,472

Excluded from the above table are promises to give of approximately $13,887,000 and $10,321,000 at December 31, 2016 and 2015, respectively that are included in assets limited as to use in the accompanying consolidated balance sheets.

6. Investments, continued

Assets Limited as to Use, *continued*

These promises to give are comprised of the following at December 31, 2016 and 2015 (dollars in thousands):

	2016	2015
Unconditional promises to give before unamortized discount and allowance for uncollectibles	$ 14,263	$ 10,666
Less: Unamortized discount	(177)	(173)
	14,086	10,493
Less: Allowance for uncollectibles	(199)	(172)
Net unconditional promises to give	$ 13,887	$ 10,321
Schedule of future amounts due:		
Less than one year	$ 6,452	$ 4,101
One to five years	6,251	4,616
Over five years	1,560	1,949
Total	$ 14,263	$ 10,666

Discount rates for these promises to give ranged from 0.67% to 1.97% and from 0.61% to 4.59% for the years ended December 31, 2016 and 2015, respectively.

THR and its wholly-controlled affiliates participate in a pooled, long term investment fund administered by THR. Amounts internally designated represent THR and its wholly-controlled affiliates pro rata share of the fund. These funds exist to provide liquidity for the System, to support its capital program, and to backstop short-term reserves as a buffer against interruption of business operations due to catastrophic events. The fund's asset allocation is a reflection of the System's investment objectives as stated in its investment policy statement. Prior to July 16, 2012, the fixed income securities in the pool, which are primarily U.S. government obligations, were designated as other-than-trading securities while the equity securities were designated as trading. As a result of modifications to THR's investment policy statement effective July 16, 2012, all purchases of fixed income securities in the pool after this date are designated as trading securities.

Management evaluates THR and its wholly-controlled affiliates' fixed income securities purchased prior to July 16, 2012 to determine whether any are deemed to be other-than-temporarily impaired due to credit worthiness of the bond issuers. There were no securities deemed to be other-than-temporarily impaired at December 31, 2016 or 2015.

At December 31, 2016, the fair value and gross unrealized losses on THR and its wholly-controlled affiliates' fixed income securities that were purchased prior to July 16, 2012 and have been in a continuous unrealized loss position for twelve months or greater were approximately $15,938,000 and $142,000, respectively. At December 31, 2016, the fair value and gross unrealized losses on THR and its wholly-controlled affiliates' fixed income securities that were purchased prior to July 16, 2012 and have been in a continuous unrealized loss position for less than twelve months were approximately $3,628,000 and $5,000, respectively. Because THR has the ability and intent to hold these investments until a market price recovery, which may be maturity, these investments are not considered other-than-temporarily impaired.

6. Investments, continued

Investment Income

Net realized investment income, included in revenue and gains in excess of expenses and losses in the consolidated statements of operations and changes in net assets, is comprised of the following for the years ended December 31, 2016 and 2015 (dollars in thousands):

	2016	2015
Interest and dividends	$ 62,547	$ 58,598
Realized gains, net	40,600	76,035
Total net realized investment income	103,147	134,633
Less: Net realized investment gain related to restricted funds	(2,017)	(2,543)
Net realized investment income, other than amount related to restricted funds	$ 101,130	$ 132,090

7. Property and Equipment

A summary of property and equipment at December 31, 2016 and 2015 is as follows (dollars in thousands):

	2016	2015
Land	$ 149,223	$ 144,912
Buildings and improvements	2,307,795	2,109,248
Fixed equipment	467,908	429,817
Major movable equipment	1,083,341	1,020,909
Building and equipment under capital lease obligations	565	1,166
	4,008,832	3,706,052
Less: Accumulated depreciation and amortization	(2,149,025)	(1,985,071)
	1,859,807	1,720,981
Construction and renovation in progress	147,938	86,468
	$ 2,007,745	$ 1,807,449

Depreciation and amortization expense related to property and equipment from continuing operations for the years ended December 31, 2016 and 2015 was approximately $217,782,000 and $210,721,000, respectively. Included in the above table is the cost, approximately $380,269,000 and $348,779,000, and accumulated depreciation, approximately $193,377,000 and $180,312,000, of land, buildings, and equipment held out for lease at December 31, 2016 and 2015, respectively.

7. Property and Equipment, continued

The System has several construction projects in progress, which include renovation and modernization of existing facilities and construction of new facilities. Total remaining estimated costs of these projects is approximately $328,711,000 of which the System has outstanding commitments of approximately $120,177,000 at December 31, 2016. Total interest capitalized during the years ended December 31, 2016 and 2015 was approximately $1,822,000 and $2,407,000, respectively.

The System recognizes a liability for the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated. Uncertainty about the timing and (or) method of settlement of a conditional asset retirement obligation is factored into the measurement of the liability when sufficient information exists. This applies to legal obligations to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. The fair value of a liability for a legal obligation associated with the retirement of long-lived assets is recognized in the period in which it is incurred. The fair value, which approximates the cost a third party would incur in performing the tasks necessary to retire such assets, is recognized at the present value of expected future cash flows and is added to the carrying value of the associated asset and depreciated over the asset's useful life.

Asset retirement obligations related to asbestos removal are recorded as other non-current liabilities in the accompanying consolidated balance sheets and totaled approximately $7,158,000 and $7,067,000 at December 31, 2016 and 2015, respectively. As a result of changes in estimated costs to abate certain types of asbestos, the System recorded increases to the liability and an increase in asbestos abatement expenses of approximately $230,000 and $495,000 during the years ended December 31, 2016 and 2015, respectively. Depreciation expense related to the associated assets was approximately $34,000 and $35,000 in 2016 and 2015, respectively. Additional accretion costs were approximately $318,000 and $325,000 for the years ended December 31, 2016 and 2015, respectively.

8. Long-Term Debt

A summary of long-term debt at December 31, 2016 and 2015 is as follows (dollars in thousands):

	2016	2015
System Revenue Bonds (Texas Health Resources), Series 2016A fixed interest rates of 2.25% to 5.00%, due through 2047	$ 631,105	$ -
System Revenue Bonds (Texas Health Resources), Series 2015 (Taxable), fixed interest rate of 4.33%, due through 2055	300,000	300,000
System Revenue Bonds (Texas Health Resources), Series 2015A fixed interest rates of 4.25% and 5.00%, due through 2052	60,000	60,000
System Tax-Exempt Loan (Texas Health Resources), The Northern Trust Company Private Loan, variable interest rates, due through 2033, (interest rate was 0.91% and 0.66% at December 31, 2016 and 2015, respectively)	67,500	67,500
System Tax-Exempt Loan (Texas Health Resources), UMB Bank N.A. Private Loan, variable interest rates, due through 2035, (interest rate was 1.09% and 0.84% at December 31, 2016 and 2015, respectively)	67,025	67,220
System Revenue Bonds (Texas Health Resources), Series 2012A (Taxable), fixed interest rate of 4.366%, due through 2047	100,000	100,000
System Revenue Bonds (Texas Health Resources), Series 2012B, variable interest rates, due through 2047 (interest rates were 0.63% and 0.01% at December 31, 2016 and 2015, respectively)	50,000	50,000

8. Long-Term Debt, continued

	2016	2015
System Revenue Bonds (Texas Health Resources), Series 2010, fixed interest rate of 5.00%, due through 2040	157,550	157,550
System Revenue Bonds (Texas Health Resources), Series 2008A, 2008B, and 2008C, variable interest rates, due through 2033, (interest rates ranged from 0.63% to 0.66% at December 31, 2016, and were 0.01% at December 31, 2015)	176,055	176,055
System Revenue Bonds (Texas Health Resources), Series 2007A and 2007B, fixed interest rate of 5.00%, due through 2047	122,235	628,855
Term and Revolving Loans (Rockwall Regional Hospital, L.L.C.), fixed and variable interest rates, due through 2023, (interest rates ranging from 2.37% to 3.52% and 2.12% to 2.37% at December 31, 2016 and 2015, respectively)	34,487	35,214
Term and Revolving Loans (Flower Mound Hospital Partners, L.L.C.), fixed and variable interest rates, due through 2022, (interest rates ranging from 1.87% to 3.32% and 1.68% to 3.32% at December 31, 2016 and 2015, respectively)	83,999	90,163
Term and Revolving Loans (AMH Cath Labs, L.L.C.), variable interest rates, due through 2022, (interest rates ranging from 1.47% to 1.87% and 1.09% to 1.49% at December 31, 2016 and 2015, respectively)	18,228	19,096
Term Loan (Health Imaging Partners, LLC), fixed interest rate of 3.87%, due through 2020	12,031	18,201
Notes Payable (Health Imaging Partners, LLC), varying rates of interest, due through 2024, (interest rates ranging from 3.60% to 5.24% and 3.60% to 6.10% at December 31, 2016 and 2015, respectively)	8,933	11,305
Capital Lease Obligations, at an imputed interest rate of 5.00% collateralized by leased equipment	253	855
Other loans and notes payable, fixed and variable interest rates due through 2032 (interest rates ranging from 2.01% to 4.00% at December 31, 2016 and 2015)	36,743	35,126
	1,926,144	1,817,140
Add:		
Unamortized original issue premium/discount, net	74,530	7,120
Less:		
Costs of Issuance	(12,475)	(9,193)
Current portion of long-term debt	(268,628)	(269,849)
Long-term debt, net of current portion	$ 1,719,571	$ 1,545,218

In December 2012, THR entered into credit agreements with Wells Fargo Bank N.A. and U.S. Bank N.A. for lines of credit of $75,000,000 each (the Credit Agreements). Under the Credit Agreements, outstanding balances under the lines of credit generally bear interest at a variable rate calculated as a percentage of LIBOR plus a spread. In December 2016, the Wells Fargo agreement was amended to extend the term date to December 31, 2019. The term date of the U.S. Bank agreement is December 31, 2017. At December 31, 2016 and 2015, there were no outstanding balances under these Credit Agreements.

8. Long-Term Debt, continued

THR issued Series 2016A bonds (Series 2016A Bonds) through Tarrant County Cultural Education Facilities Finance Corporation (official statement dated October 5, 2016) in the amount of $631,105,000. The proceeds of the Series 2016A Bonds were used to (a) currently refund a portion of the Tarrant County Cultural Education Facilities Finance Corporation Texas Health Resources System Refunding Revenue Bonds, Series 2007A, (b) finance and or reimburse certain capital projects of THR, and (c) pay costs of issuance of the Series 2016A Bonds.

THR issued Series 2015 Taxable (Series 2015 Taxable Bonds) and 2015A (Series 2015A Bonds) bonds (collectively the Series 2015 Bonds) through Tarrant County Cultural Education Facilities Finance Corporation (official statements dated April 28 and May 6, 2015) in the amounts of $300,000,000 and $60,000,000, respectively. The proceeds of the Series 2015 Bonds were used (a) to finance and or reimburse certain capital projects of THR, (b) to pay costs of issuance of the Series 2015 Bonds, and (c) for other eligible corporate purposes.

Effective July 31, 2015, THR refinanced tax-exempt advancing term loan agreements (Bank Loans) with Kansas City Financial Corporation, an affiliate of UMB Bank, N.A. (UMB) and The Northern Trust Company (Northern). The UMB bank loan was issued for $67,375,000 with a final maturity date of September 1, 2035, and an optional tender date of July 31, 2030. The Northern bank loan was issued for $67,500,000 with a final maturity date of December 1, 2033, and a mandatory tender date of July 31, 2025. Both new bank loans bear interest at variable rates calculated as a percentage of LIBOR plus a spread. The refinanced notes were effective November 2010, with Bank of America, N.A. and Compass Mortgage Corporation in the aggregate principal amount of $135,000,000. The proceeds of these Bank Loans were used to (a) pay costs of acquiring, constructing, renovating, remodeling and/or equipping capital improvements for certain THR tax-exempt health facilities and (b) pay certain costs incurred in connection with the Bank Loans.

THR issued Series 2012A (Series 2012A Bonds) and 2012B (Series 2012B Bonds) bonds (collectively the Series 2012 Bonds) through Tarrant County Cultural Education Facilities Finance Corporation (official statements dated September 27, 2012) in the amounts of $100,000,000 and $50,000,000, respectively. The proceeds of the Series 2012 Bonds were used to (a) finance and reimburse THR for the costs of the acquisition, construction, renovation, remodeling and/or equipping of capital improvements and (b) pay certain costs incurred in connection with the issuance of the Series 2012 Bonds. The Series 2012B Bonds are tax-exempt variable rate demand bonds, and are as such subject to periodic tender and remarketing provisions. The interest rates at which the bonds are remarketed are determined in accordance with the remarketing agreement applicable to the Series 2012B Bonds. Liquidity for payment of the Series 2012B Bonds tendered for purchase and not remarketed is provided by THR under a self liquidity program. As a result, THR has classified the Series 2012B Bonds as a current liability in the current portion of long-term debt. Actual scheduled principal repayment dates range from 2041 – 2047.

THR issued Series 2010 bonds (the Series 2010 Bonds) through the Tarrant County Cultural Education Facilities Finance Corporation (official statement dated November 11, 2010) in the amount of $157,550,000. The proceeds of the Series 2010 Bonds were used to (a) to refund the Tarrant County Cultural Education Facilities Finance Corporation Texas Health Resources System Revenue Bonds, Series 2008D, 2008F, and 2008G; and (b) to pay certain costs incurred in connection with the issuance of the Series 2010 Bonds and the provisions for payment of the refunded Series 2008D, 2008F, and 2008G Bonds.

8. Long-Term Debt, continued

THR issued Series 2008A-G bonds (the Series 2008 Bonds) through the Tarrant County Cultural Education Facilities Finance Corporation (official statement dated October 27, 2008) in the amount of $366,120,000. The proceeds of the Series 2008 Bonds were used (a) to refund the Tarrant County Health Facilities Development Corporation Texas Health Resources System Revenue Bonds, Series 2003 (the Series 2003 Bonds) ($300,000,000) and the Plano Health Facilities Development Corporation Unit Priced Demand Adjustable Revenue Bonds (Children's and Presbyterian Healthcare Center of North Texas Project) Series 1989 (the Series 1989 Bonds) ($27,900,000); (b) to finance or refinance the purchase, development, construction, reconstruction, renovation, rehabilitation and/or equipping of certain THR tax-exempt health facilities ($35,900,000); and, (c) pay certain costs incurred in connection with the issuance of the Series 2008 Bonds and the provisions for payment of the refunded Series 2003 and Series 1989 Bonds. As previously discussed, THR defeased all of the outstanding Series 2008D, 2008F, and 2008G Bonds in November 2010, with proceeds from the issuance of the Series 2010 Bonds. In addition, THR redeemed all of the outstanding Series 2008E Bonds on November 22, 2010 at a purchase price equal to the principal amount ($36,140,000) thereof plus interest accrued thereon to the redemption date. THR used available cash to redeem the Series 2008E Bonds. In May 2015, THR remarketed the Series 2008C Bonds converting them from a daily to a weekly rate and converting the liquidity provision from a Standby Bond Purchase Agreement (SBPA) to self-liquidity.

The Series 2008 Bonds are variable rate demand bonds. Accordingly, the Series 2008 Bonds are subject to periodic tender and remarketing provisions. The interest rates at which the bonds are remarketed are determined in accordance with the remarketing agreement applicable to each series of the Series 2008 Bonds. Liquidity for payment of the outstanding Series 2008 Bonds tendered for purchase and not remarketed is provided by THR under a self liquidity program. As a result, THR has classified these series as current liabilities in the current portion of long-term debt. Actual scheduled principal repayment dates range from 2027 – 2033. Prior to the May 2015 remarketing, liquidity for payment of the Series 2008C Bonds tendered for purchase and not remarketed was provided by an SBPA with JPMorgan Chase Bank, N.A.

Concurrent with the issuance of the Series 1997 Bonds and amended in connection with the issuance of the Series 2008, Series 2012, Series 2015 Bonds, and Series 2016A Bonds, THR entered into the Second Amended and Restated Master Trust Indenture (the Master Indenture). Among other requirements, THR granted a security interest in (a) certain of its revenue (as defined in the Master Indenture) and accounts receivable of the grantor; (b) all money and investments held or required to be held for the credit of the funds and accounts established by or under the Master Indenture; and (c) any and all property that may, from time to time, be subjected to the lien and security interest of the Master Indenture.

In April and May 2007, at THR's request, Tarrant County Cultural Education Facilities Finance Corporation issued $597,840,000 of Refunding Revenue Bonds and $100,000,000 of Revenue Bonds, Series 2007A and 2007B, respectively. The proceeds of the Series 2007A Bonds were used (a) to provide payment of principal, redemption premium, and interest to redemption or maturity on $366,985,000 outstanding Series 1997A Bonds, $157,090,000 outstanding Series 1997B Bonds, and $68,745,000 outstanding Series 1997C Bonds, and (b) to pay certain costs incurred in connection with the issuance of the Series 2007A Bonds and the provisions for the refunded bonds. As previously discussed, in November 2016, THR refunded a portion of the outstanding Series 2007A Bonds from the issuance of the Series 2016A Bonds. At December 31, 2016, the remaining outstanding balance of the Series 2007A Bonds is $22,000,000, which is due to mature on February 15, 2017. The proceeds of the sale of the Series 2007B Bonds were used (a) to pay or reimburse THR for the costs of acquiring, constructing, renovating, remodeling, and/or equipping capital improvements for THR and its tax-exempt controlled affiliates, and (b) to pay certain costs incurred in connection with the issuance of the Series 2007B Bonds.

8. Long-Term Debt, continued

On December 21, 2010, Rockwall entered into a Credit Agreement with JPMorgan Chase Bank N.A (the Chase Agreement). The Chase Agreement provides Rockwall with a Real Estate Term Loan of $42,000,000, an Equipment Term Loan of $13,000,000, and a Revolving Loan of $5,000,000 to be used as working capital. Under the Chase Agreement, outstanding balances bear interest based on a one-, two-, or three-month LIBOR rate, plus 1.95%. On March 31, 2016, Rockwall refinanced its Real Estate Term Loan and Equipment Term Loan with an amended and restated credit agreement with JP Morgan Chase Bank, NA. The refinanced Chase Agreement provides Rockwall with a term loan of $36,301,600 comprised of a fixed rate term loan of $25,550,000 bearing interest at 3.52% and a variable rate term loan of $10,751,600 bearing interest based on one-, two-, three-, or six-month LIBOR, plus 1.75%. The balance outstanding on all Term Loans as of December 31, 2016 and 2015 was approximately $34,487,000 and $35,214,000, respectively. There were no amounts outstanding on the Revolving Loan as of December 31, 2016 and 2015.

On January 13, 2011, Rockwall entered into a forward-starting swap agreement with JPMorgan Chase with respect to the $42,000,000 Real Estate Term Loan. This swap was intended to reduce the financial risk related to rising LIBOR interest rates by executing a cash flow hedge to convert the floating rate exposure to a fixed rate hedge instrument. The fixed rate on this hedge is 2.70%, with a start date of January 31, 2011. The interest rate swap agreement was terminated on March 31, 2016 as part of the refinancing discussed above with a settlement payout of approximately $1,087,000, of which approximately $56,000 was a payment of accrued interest, and approximately $1,031,000 was a payment to settle the outstanding swap liabilities. The fair value of the swap was a liability of approximately $1,026,000 at December 31, 2015, of which approximately $626,000 is included in other accrued liabilities with the remainder included in other noncurrent liabilities on the accompanying consolidated balance sheets. The increase or decrease in the fair value for the ineffective portion of the swap is recorded in other nonoperating gains (losses) in the accompanying consolidated statements of operations and changes in net assets and amounted to approximately ($98,000) and ($54,000) for the years ended December 31, 2016 and 2015, respectively. The remainder of the increase or decrease in the fair value for the years ended December 31, 2016 and 2015 is recorded in other changes in unrestricted net assets and revenue and gains in excess of expenses and losses attributable to non-controlling interest in the accompanying consolidated statements of operations and changes in net assets. Realized gains and losses (settlements) on interest hedge derivatives are recorded as adjustments to interest expense in the statements of operations and are included in cash flows from operating activities in the statements of cash flows. For the year ended December 31, 2015, settlements totaled approximately $836,000.

On February 28, 2008, Flower Mound entered into a Credit Agreement (the Agreement) with various lending institutions with JPMorgan Chase Bank, NA acting as agent for the lenders. The Agreement provided Flower Mound with an Advancing Term Loan Commitment of $105,000,000 and a Revolving Loan Commitment of $3,000,000 used as working capital. During 2014, the Agreement was amended to provide additional Term Loans of $11,280,000, comprised of a fixed rate term loan of $7,896,000 and a variable rate term loan of $3,384,000 bearing interest at LIBOR plus 1.43%. On December 22, 2015, Flower Mound refinanced its Advancing Term Loan Commitment with an amended and restated credit agreement with JP Morgan Chase. The refinanced agreement provides Flower Mound with a Term Loan of $81,176,000 comprised of a fixed rate term loan of $57,400,000 bearing interest at 3.32% and a variable rate term loan of $23,776,000 bearing interest on one-, two-, three-, or six-month LIBOR, plus 1.43%. The balance outstanding on all Term Loans as of December 31, 2016 and 2015 was approximately $83,999,000 and $90,163,000, respectively. There were no amounts outstanding on the Revolving Loan as of December 31, 2016 and 2015.

8. Long-Term Debt, continued

On March 10, 2008, Flower Mound entered into a forward-starting interest swap agreement with JPMorgan Chase with respect to $73,500,000 of the Advancing Term Loan. This swap was intended to reduce the financial risk related to rising LIBOR interest rates by executing a cash flow hedge that converted the floating rate exposure to a fixed rate hedge instrument. The fixed rate on the hedge was 4.76% with a start date of September 30, 2009. The interest rate swap agreement was terminated on December 22, 2015 as part of the refinancing discussed above with a settlement payout of approximately $4,433,000, of which approximately $523,000 was a payment of accrued interest, and approximately $3,910,000 was a payment to settle outstanding swap liabilities. For the year ended December 31, 2015, the increase in the fair value prior to the termination of approximately $1,678,000 is recorded in other nonoperating gains (losses) in the accompanying consolidated statement of operations and changes in net assets. For the year ended December 31, 2015, settlements totaled approximately $2,438,000.

On December 28, 2011, ACL entered into Loan Agreements with Bank of America, N.A. (the Agreements). The Agreements provide ACL with a ten year floating rate Service Line Term Loan of $15,300,000, a seven year floating rate Equipment Term Loan of $6,400,000, and a five year floating rate Revolving Line of Credit of $10,000,000. The loans bear interest at LIBOR plus a credit spread of 1.3% for the Service Line Term Loan and 0.9% for the Equipment Term Loan and Revolving Line of Credit. Balances outstanding as of December 31, 2016 and 2015, respectively, were approximately $12,852,000 and $13,464,000 on the Service Line Term Loan and approximately $5,376,000 and $5,632,000 on the Equipment Term Loan. There was no outstanding balance on the Revolving Line of Credit as of December 31, 2016 and 2015.

On December 22, 2011, ACL entered into Interest Rate Swap Agreements with Bank of America N.A. with respect to the Service Line and Equipment Term Loans. These swaps are intended to reduce the financial risk related to rising LIBOR interest rates by executing a cash flow hedge that will convert the floating rate exposure to a fixed rate hedge instrument. The fixed rate on the Service Line Term Loan hedge is 2.0025%, with a start date of December 28, 2011 and ending date of January 1, 2022. The fixed rate on the Equipment Term Loan hedge is 1.6470%, with a start date of December 28, 2011 and ending date of January 1, 2019. The fair value of the swaps at December 31, 2016 and 2015 was a liability of approximately $164,000 and $315,000, respectively, and is included in other noncurrent liabilities on the accompanying consolidated balance sheets. All of the increase or decrease in the fair value of the swaps for the years ended December 31, 2016 and 2015 is recorded in other changes in unrestricted net assets and revenue and gains in excess of expenses and losses attributable to non-controlling interest in the accompanying consolidated statements of operations and changes in net assets. For the years ended December 31, 2016 and 2015, settlements totaled approximately $261,000 and $353,000, respectively.

In December 2013, HIP entered into a Senior Secured Credit Facility with KeyBank National Association (the Credit Facility). The Credit Facility provides HIP with a seven year fixed rate Term Loan of $28,500,000 bearing interest at 3.87%. The balance outstanding on the Term Loan as of December 31, 2016 and 2015 was approximately $12,031,000 and $18,201,000, respectively.

8. Long-Term Debt, continued

Scheduled principal repayments on long-term debt are as follows (dollars in thousands):

Year Ending December 31,	Scheduled Principal Payments	Principal Based on Liquidity Provisions
2017	$ 42,573	$ 268,628
2018	18,462	18,462
2019	19,957	19,957
2020	10,177	10,177
2021	15,662	15,662
Thereafter	1,819,313	1,593,258
Total	$ 1,926,144	$ 1,926,144

The Master Indenture, Bank Loans and Credit Agreements contain various covenants which require, among other things, the maintenance of certain financial ratios and certain other restrictions. Management believes THR is in compliance with its covenants as of December 31, 2016.

9. Net Assets

Temporarily Restricted Net Assets

Temporarily restricted net assets at December 31, 2016 and 2015 were restricted for the following purposes (dollars in thousands):

	2016	**2015**
Patient care	$ 24,282	$ 17,845
Capital improvements	19,923	23,104
Education and training	19,312	18,626
Research	11,071	9,381
Community outreach	8,021	6,732
Other restricted purposes	9,153	9,049
	$ 91,762	$ 84,737

9. Net Assets, continued

Permanently Restricted Net Assets

Permanently restricted net assets at December 31, 2016 and 2015 were restricted by donors to be maintained by THR in perpetuity for the following purposes (dollars in thousands):

	2016	2015
Education and training	$ 25,075	$ 24,681
Patient care	12,765	12,426
Research	12,477	12,383
Capital improvements	3,705	3,669
Community outreach	2,643	2,627
Other restricted purposes	12,978	13,081
	$ 69,643	$ 68,867

10. Endowment

The System's endowments consist of donor-restricted endowment funds and funds designated by the Board of Trustees to function as endowments. Net assets associated with endowment funds, including funds designated by the Board of Trustees to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

Based on the interpretation of the Uniform Prudent Management of Institutional Funds Act (UPMIFA) by the Board of Trustees, the guidance in FASB ASC 958-205, Not-for-Profit Entities Presentation of Financial Statements, and absent explicit donor stipulations to the contrary, the System classifies the original value of gifts donated to the permanent endowment as well as accumulations to the permanent endowment made at the direction of the donor or by policy as permanently restricted net assets. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the System in a manner consistent with the standard of prudence prescribed in UPMIFA.

In accordance with UPMIFA, the System considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

(1) The duration and preservation of the fund
(2) The purposes of the Foundation and the donor-restricted endowment fund
(3) General economic conditions
(4) The possible effect of inflation and deflation
(5) The expected total return from income and the appreciation of investments
(6) Other resources of the Foundation
(7) The investment policies of the Foundation

10. Endowment, continued

Changes in the System's invested endowment assets for the years ended December 31, 2016 and 2015 are as follows (dollars in thousands):

	Board Designated Endowment Funds	Donor- Restricted Endowment Funds		Total
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total Endowment Funds
Balance at December 31, 2014	$ 56,015	$ 40,578	$ 56,355	$ 152,948
Contributions collected	-	-	575	575
Interest and dividends	592	1,229	-	1,821
Realized and unrealized gains, net	(1,064)	(5,773)	53	(6,784)
Amounts appropriated for expenditure	(269)	(3,717)	-	(3,986)
Balance at December 31, 2015	55,274	32,317	56,983	144,574
Contributions collected	-	-	355	355
Interest and dividends	578	1,147	-	1,725
Realized and unrealized gains (losses), net	2,468	2,990	525	5,983
Transfers	-		-	-
Amounts appropriated for expenditure	(245)	(1,152)	-	(1,397)
Balance at December 31, 2016	$ 58,075	$ 35,302	$ 57,863	$ 151,240

From time to time, the fair value of assets associated with an individual donor-restricted endowment fund may fall below the original value of the fund. In accordance with GAAP, deficiencies of this nature are reported in unrestricted net assets and were approximately $22,000 as of December 31, 2015. These deficiencies resulted from unfavorable market fluctuations that occurred after the investment of permanently restricted contributions and continued appropriation for certain programs that were deemed prudent by the Board of Trustees. There were no deficiencies of this nature as of December 31, 2016.

The System has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Under this policy, the endowment assets are invested in securities and other instruments which compliment or balance one another, thereby reducing risk without significantly reducing average returns.

To satisfy its long-term rate-of-return objectives, the System relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The System targets a diversified asset allocation that places a greater emphasis on equity-based investments to achieve its long-term return objectives within prudent risk constraints.

The System has spending policies that allow up to 4% of the endowment to be appropriated for expenditure unless otherwise stipulated in the donor agreement, calculated after the endowment principal has been increased by the annual Consumer Price Index. This is consistent with the System's objectives to maintain the purchasing power of the endowment assets held in perpetuity or for a specified term as well as to provide additional real growth.

11. Non-Controlling Interests

The System controls and therefore consolidates certain investments in its joint ventures with physicians and non-physicians to operate hospitals and other health related ventures. The activity for non-controlling interests for the years ended December 31, 2016 and 2015 is summarized below (dollars in thousands):

	2016	2015
Non-controlling ownership interest in equity of consolidated affiliates, beginning of year	$ 102,000	$ 92,106
Revenue and gains in excess of expenses and losses attributable to non-controlling interest	83,284	67,306
Non-controlling interest in change in fair value of interest rate swap agreements	507	298
Contributions from non-controlling interest holders	3,380	4,933
Distributions to non-controlling interest holders	(78,474)	(62,643)
Non-controlling ownership interest in equity of consolidated affiliates, end of year	$ 110,697	$ 102,000

12. Retirement Plans

The System has various plans, primarily defined contribution plans, which cover eligible full-time and part-time employees of the System. Plan contributions, included in salaries, wages, and employee benefits in the consolidated statements of operations and changes in net assets, were approximately $60,934,000 and $60,788,000 for the years ended December 31, 2016 and 2015, respectively.

13. Federal and State Income Taxes

The System has certain subsidiaries and operations such as joint venture interests, retail pharmacies and outside laboratory services that are taxable for federal income tax purposes. The taxable activities of all includible entities have approximately $2,491,000 and $458,000 in net deferred tax assets, against which a 100% valuation allowance has been recorded, for the years ended December 31, 2016 and 2015, respectively. While the System expects to generate taxable income from certain activities in the future, the valuation allowance has been recorded because the System does not believe taxable income will be incurred by the entities that generated the net deferred tax assets.

The Texas franchise tax applies to certain of the System's consolidated for-profit and joint venture interests. Under this law, tax is calculated on a margin base and is therefore reflected in the System's statements of operations and changes in net assets as income tax expense.

Federal and state income tax expense (benefit) of approximately $3,606,000 and $4,608,000 is included in the consolidated statements of operations and changes in net assets for the years ended December 31, 2016 and 2015, respectively.

14. Concentrations of Credit Risk

Financial institutions that potentially subject the System to concentrations of credit risk consist of deposits in banks and investments in excess of the Federal Deposit Insurance Corporation, Securities Investor Protection Corporation and other privately insured limits. The System has not experienced any credit losses on these financial instruments.

The hospitals and physician practices grant credit without collateral to their patients, most of whom are local residents and are insured under third-party payor agreements. The mix of gross receivables from patients and third-party payors at December 31, 2016 and 2015 is as follows:

	2016	2015
Medicare	17%	19%
Medicare Managed Care	11%	13%
Medicaid	1%	2%
Medicaid Managed Care	5%	5%
Managed care organizations	41%	47%
Other third-party payors	4%	3%
Patients	21%	11%
	100%	100%

15. Commitments and Contingencies

Management evaluates contingencies based upon available evidence. In addition, allowances for losses are provided each year for disputed items which have continuing significance. Management believes that allowances for losses have been provided to the extent necessary and that its assessment of contingencies is reasonable. Due to the inherent uncertainties and subjectivity involved in accounting for contingencies, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. To the extent that the resolution of contingencies results in amounts which vary from management's estimates, future operating results will be charged or credited. The principal commitments and contingencies are described below:

Professional and General Liability Insurance

The System has known professional and general liability claims and incidents that may result in the assertion of claims, as well as exposure from unknown incidents that may be asserted. In connection with these risks, THR maintains a self-insurance program for the professional and general liabilities of THR and its wholly-controlled affiliates whereby undiscounted reserves are recorded based on actuarial estimates from an independent third-party actuary. The self-insurance program includes coverage for general liability exposure of THPG. In connection with the self-insurance program, THR formed Grace Indemnity Company, Ltd., a wholly-owned captive insurance company in December 2014, for the purpose of paying professional liability and general liability claims. Prior to January 1, 2015, THR maintained trust funds, which held assets for the purpose of paying potential professional liability and general liability claims. The System also purchases insurance for professional liability and general liability claims in excess of THR's self-insurance retention level.

The System purchased claims-made professional liability coverage from commercial carriers for providers employed by THPG until December 31, 2014. The captive is also used to pay historical professional liabilities of THPG that occurred and are unknown prior to December 31, 2015, and all known and unknown liabilities that occur on or after January 1, 2015. The System's consolidated joint ventures each maintain separate professional and general liability insurance programs covering their risks individually.

15. Commitments and Contingencies, continued

Professional and General Liability Insurance, continued

The System's established liability for professional and general liability claims was approximately $34,462,000 and $30,456,000 at December 31, 2016 and 2015, respectively, and is recorded in other accrued liabilities and other non-current liabilities in the accompanying consolidated balance sheets.

Workers' Compensation Insurance

The System purchases workers' compensation insurance from commercial carriers with per claim deductibles and aggregate limits. Accrued claims include estimates for known claims and incidents incurred but not reported at December 31, 2016 and 2015, respectively. The System's established liability for workers' compensation claims was approximately $4,493,000 and $5,186,000 at December 31, 2016 and 2015, respectively, and is recorded in other accrued liabilities in the accompanying consolidated balance sheets.

Employee Health Insurance

THR maintains a self-insurance medical plan for the employees of THR and its wholly-controlled affiliates. Accrued claims include estimates for known claims and services incurred but not reported at December 31, 2016 and 2015, respectively. THR also purchases stop-loss insurance to limit its losses on claims for medical expenses. The System's consolidated joint ventures each maintain separate employee health insurance programs. The System's established liability for employee health claims was approximately $20,527,000 and $18,398,000 at December 31, 2016 and 2015, respectively, and is recorded in accrued salaries, wages, and employee benefits in the accompanying consolidated balance sheets.

Guarantees of Indebtedness

The Tax-Exempt Hospitals guaranteed approximately $21,243,000 and $22,558,000 of patient notes purchased by banks at December 31, 2016 and 2015, respectively. The System recorded a contingent liability of approximately $5,848,000 and $6,705,000 at December 31, 2016 and 2015, respectively, for these guarantees based on historical default rates.

In February, 2013, THR entered into a limited guaranty agreement with JPMorgan Chase Bank, N.A. (JPM) for 51% of any indebtedness outstanding between JPM and USMD Arlington. In May, 2013, THR entered into a limited guaranty agreement with Southwest Bank for 51% of any indebtedness outstanding between Southwest Bank and USMD Fort Worth up to a maximum guaranty amount of $6,150,000. In September 2015, the limited guaranty agreement for USMD Arlington was amended in conjunction with their debt refinancing. At December 31, 2016 and 2015, THR's share of principal on USMD Arlington's and USMD Fort Worth's outstanding indebtedness was approximately $14,278,000 and $3,773,000, and $22,817,000 and $4,645,000, respectively. Payments are due from THR if USMD Arlington or USMD Fort Worth is unable to fulfill its obligations at the scheduled payment dates. As of December 31, 2016, it is not probable that THR will be required to make significant payments under the limited guaranty agreements. No amounts have been recorded in the accompanying consolidated financial statements for these guarantees.

Litigation

The System is a party to several legal actions arising in the ordinary course of its business. In management's opinion, the System has adequate legal defenses, insurance coverage, and (or) self-insured retention for each of these actions, and management estimates that these matters will be resolved without material adverse effect on the System's future financial position, results of operations, or cash flows.

15. Commitments and Contingencies, continued

Regulatory Compliance

The health care industry is subject to numerous laws and regulations of federal, state, and local governments and compliance can be subject to future review and interpretation as well as the possible emergence of regulatory actions unknown or unasserted at this time. Management believes that the System is in substantial compliance with applicable government laws and regulations. Regulatory inquiries and voluntary reports may be made from time-to-time. It is management's policy to cooperate fully in resolving any such reports or inquiries.

In March 2015, the System made a disclosure to the Office of Inspector General (OIG) regarding THPG billing of certain PET scan tests and nuclear stress tests that did not meet Medicare medical necessity requirements. Management believes it is too early to predict with certainty the outcome of this matter; however, management does not anticipate a material financial impact.

THR's Corporate Compliance Department investigates all compliance matters reported through its compliance program. As of the date of these financial statements, there was no additional pending or, to the knowledge of System management, threatened litigation, including professional liability claims, or reported compliance issues which in the opinion of System management involves any substantial risk of material liability for the System, and where applicable, in excess of available reserves and insurance coverage. In management's opinion, the System does not expect the resolution of any known regulatory compliance matters to have a material adverse effect on the System's future financial position, results of operations, or cash flows.

Operating Leases

The System leases various equipment and facilities under operating leases expiring at various dates through 2030. Total rental expense, included in other operating expenses in the consolidated statements of operations and changes in net assets, was approximately $69,437,000 and $72,569,000 for the years ended December 31, 2016 and 2015, respectively.

The following is a five year schedule, by year, of future minimum lease payments under non-cancelable operating leases that have initial terms in excess of one year as of December 31, 2016 (dollars in thousands):

Year Ending December 31,	
2017	$ 51,132
2018	42,479
2019	32,959
2020	23,227
2021	20,439
Thereafter	52,243
	$ 222,479

The System leases office space and land at fair market value to non-THPG physicians, health care related businesses, and others under operating leases expiring at various dates through 2072. Total rental income, included in other operating revenue and other non-operating gains in the consolidated statements of operations and changes in net assets, was approximately $33,402,000 and $31,226,000 for the years ended December 31, 2016 and 2015, respectively.

15. Commitments and Contingencies, continued

Operating Leases, *continued*

The following is a five-year schedule, by year, of future minimum rental income payments under non-cancelable leases that have initial terms in excess of one year as of December 31, 2016 (dollars in thousands):

Year Ending December 31,	
2017	$ 26,367
2018	20,373
2019	16,596
2020	14,178
2021	11,320
Thereafter	145,678
	$ 234,512

16. Functional Operating Expenses

The System provides general and comprehensive health care services to residents within its geographic locations. Operating expenses related to providing these services for the years ended December 31, 2016 and 2015 were as follows (dollars in thousands):

	2016	**2015**
Patient care services	$ 3,509,160	$ 3,356,187
General and administrative	630,028	544,392
Research and physician education	37,377	15,474
Fundraising	6,374	6,127
	$ 4,182,939	$ 3,922,180

17. Fair Value Measurements

The System follows the provisions of FASB ASC 820, *Fair Value Measurements and Disclosures*, for its financial assets and liabilities that are measured and reported at fair value each reporting period. The financial assets recorded at fair value on a recurring basis primarily relate to investments, assets limited as to use, interest rate swap agreements, and contributions receivable from split-interest agreements. FASB ASC 820 establishes a fair value hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity (observable inputs that are classified within Levels 1 and 2 of the hierarchy) and the reporting entity's own assumptions about market participant assumptions (unobservable inputs classified within Level 3 of the hierarchy).

17. Fair Value Measurements, continued

The following tables present information about the System's assets and liabilities (dollars in thousands) that are measured at fair value on a recurring basis as of December 31, 2016 and 2015, and indicates the fair value hierarchy of the valuation techniques utilized to determine such fair value. In general, fair values determined by Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities. Fair values determined by Level 2 inputs utilize data points that are observable, such as quoted prices, interest rates and yield curves. Fair values determined by Level 3 inputs are unobservable data points for the asset or liability, and include situations where there is little, if any, market activity for the asset or liability. The System's assets limited as to use that are categorized as Level 3, or valued using significant unobservable inputs, primarily represent an investment in the Texas Methodist (formerly Central Texas Methodist) Foundation, contributions receivable from split-interest agreements and an endowment fund primarily holding mineral interests that are valued based on a multiple of annual revenues.

	2016	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash and cash equivalents	$ 107,161	$ 106,331	$ 830	$ -
Domestic equity securities:				
Cash equivalents	55,634	55,634	-	-
Mutual funds	97,331	97,331	-	-
Common collective trust	259,320	259,320	-	-
Energy	104,471	104,082	389	-
Materials	79,073	79,073	-	-
Industrials	115,275	115,177	98	-
Consumer discretionary	198,337	197,776	561	-
Consumer staples	99,384	99,093	291	-
Health care	225,337	224,486	851	-
Financials	385,032	384,236	796	-
Information technology	381,900	381,790	110	-
Telecommunication services	30,616	30,307	309	-
Utilities	30,377	30,291	86	-
Other	15,413	11,141	4,272	-
International equity securities:				
Mutual funds	228,589	228,589	-	-
Common collective trusts	440,039	440,039	-	-
Fixed income securities:				
Cash equivalents	49,859	-	49,859	-
U.S. Government	25,964	-	25,964	-
Corporate bonds	306,299	-	306,299	-
Agency mortgages	514,348	-	514,348	-
U.S. Agencies	522,421	-	522,421	-
Other	6,393	-	6,393	-
Mutual funds (blended securities)	8,875	2,561	6,314	-
Texas Methodist Foundation	1,188	-	-	1,188
Real estate	736	-	718	18
Mineral interests	2,050	-	-	2,050
Contributions receivable from split-interest agreements	1,510	-	-	1,510
Total assets	$ 4,292,932	$ 2,847,257	$ 1,440,909	$ 4,766
Interest rate swap agreements	$ (164)	$ -	$ (164)	$ -

17. Fair Value Measurements, continued

	2015	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash and cash equivalents	$ 46,811	$ 45,868	$ 943	$ -
Domestic equity securities:				
Cash equivalents	35,645	35,645	-	-
Mutual funds	87,166	87,166	-	-
Common collective trust	230,933	230,933	-	-
Energy	76,196	75,870	326	-
Materials	71,000	71,000	-	-
Industrials	105,468	105,468	-	-
Consumer discretionary	194,211	193,797	414	-
Consumer staples	73,007	72,706	301	-
Health care	235,282	234,495	787	-
Financials	332,596	331,817	779	-
Information technology	348,254	348,181	73	-
Telecommunication services	30,123	29,862	261	-
Utilities	29,011	28,956	55	-
Other	16,408	12,899	3,509	-
International equity securities:				
Mutual funds	245,535	245,535	-	-
Common collective trusts	304,129	304,129	-	-
Fixed income securities:				
Cash equivalents	35,915	-	35,915	-
U.S. Government	38,422	-	38,422	-
Corporate bonds	264,035	-	264,035	-
Agency mortgages	485,628	-	485,628	-
U.S. Agencies	556,827	-	556,827	-
Other	2,809	-	2,809	-
Mutual funds (blended securities)	6,760	586	6,174	-
Hedge funds	1,347	-	1,347	-
Texas Methodist Foundation	1,179	-	-	1,179
Real estate	736	-	718	18
Mineral interests	3,065	-	-	3,065
Contributions receivable from split-interest agreements	1,574	-	-	1,574
Total assets	$ 3,860,072	$ 2,454,913	$ 1,399,323	$ 5,836
Interest rate swap agreements	$ (1,340)	$ -	$ (1,340)	$ -

Included in assets limited as to use in the accompanying consolidated balance sheets is approximately $12,377,000 and $8,747,000 at December 31, 2016 and 2015, respectively, of pledges receivable that have been excluded from the above tables.

The System's policy is to recognize transfers between levels of the fair value hierarchy on the date of the event or change in circumstances that caused the transfer. During the year ended December 31, 2016, the System reallocated approximately $69,000,000 in funds within its long term investment pool from its bond portfolio to equity managers representing a transfer from level 2 to level 1. There were no such reallocations during the year ended December 31, 2015.

17. Fair Value Measurements, continued

The change in the fair value of the System's assets limited as to use valued using significant unobservable inputs (Level 3) is shown below (dollars in thousands):

	2016	2015
Fair value recorded at beginning of year	$ 5,836	$ 9,175
Adjustment to record increase in estimated fair value due to realized investment gains	9	9
Adjustment to record increase (decrease) in estimated fair value due to unrealized gains (losses)	(1,015)	(3,232)
Change in value of splilt-interest agreements	(64)	(116)
Fair value recorded at end of year	$ 4,766	$ 5,836

The adjustment to record the increase (decrease) in estimated fair value due to realized and unrealized gains (losses) on the investments valued using significant unobservable inputs is included in changes in temporarily and permanently restricted net assets in the accompanying consolidated statements of operations and changes in net assets. The change in value of split-interest agreements on the investments valued using significant unobservable inputs is included in changes in unrestricted and temporarily restricted net assets in the accompanying consolidated statements of operations and changes in net assets. The increase in unrealized gains (losses) relating to assets still held at December 31, 2016 and 2015 is approximately $(1,015,000) and $(3,201,000), respectively.

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

Cash and Cash Equivalents

The carrying amounts, at face value or cost plus accrued interest, approximate fair value because of the short maturity of these instruments.

Equity Securities

Equity securities held by THR or held in trust controlled by THR are measured using quoted market prices. Equity securities held in trust not controlled by THR are measured using the net asset value of the trust based on the fair value of underlying securities, which are measured using quoted market prices.

Fixed Income Securities

Fixed income securities are measured using quoted market prices, if available, or estimated using quoted market prices for similar assets.

Common Collective Trusts

Investments in common collective trusts may be accessed at any time at the net asset value as reported by the manager on a daily basis. THR's interest in these trusts contains no other rights or obligations. As such, net asset value represents fair value for these investments. Each common collective trust invests in either equity or fixed income securities.

17. Fair Value Measurements, continued

Mutual Funds

Values of investments in mutual funds are based on quoted market prices for publicly traded funds and net asset values for funds that are not publicly traded. THR's interest in these funds contains no other rights or obligations. As such, net asset value represents fair value for these investments. Each fund invests in either equity or fixed income securities.

Hedge Funds

Values of investments in hedge funds are based on net asset value as estimated by the general partner of the hedge fund based on the underlying securities which are primarily level 1 and 2 financial instruments and reviewed by management of THR.

Texas Methodist Foundation

The value of the investment in the Texas Methodist Foundation is estimated by the manager of the foundation based on the valuation of loans made by the foundation.

Real Estate

Investments in real estate are measured by private valuations.

Mineral Interests

Investments in mineral interests are estimated based on a multiple of annual revenues.

Contributions Receivable from Split-Interest Agreements

The fair value of the contribution is measured at the present value of the estimated future cash receipts from the trust's assets.

Long-Term Debt

Fair value of the System's long-term debt is estimated based on the quoted market prices for the same or similar issues or on the current rates offered to the System for debt of the same remaining maturities and is therefore classified as Level 2 under the fair value hierarchy. The carrying amounts and fair value of the System's long-term debt at December 31, 2016 and 2015 were as follows (dollars in thousands):

	Book Value		Estimated Fair Value	
	2016	**2015**	**2016**	**2015**
Fixed rate	$ 1,543,030	$ 1,328,169	$ 1,536,659	$ 1,508,911
Variable rate	443,650	476,158	443,650	476,158
Other	13,994	19,933	13,994	19,933
	$ 2,000,674	$ 1,824,260	$ 1,994,303	$ 2,005,002

Interest Rate Swap Agreements

Current market pricing models were used to estimate fair values of interest rate swap agreements.

17. Fair Value Measurements, continued

Other Financial Instruments

The carrying amount reported in the consolidated balance sheets for cash and cash equivalents, receivables, accounts payable, estimated third-party settlements, accrued salaries, wages, and employee benefits, and other accrued liabilities approximates its fair value due to the short-term nature of these financial instruments.

18. Investments in Unconsolidated Affiliates

THR and its controlled affiliates participate with other organizations, physicians, and non-physicians to provide health care related services. At December 31, 2016, THR and its controlled affiliates own interests in Community Hospice of Texas (Hospice), a provider of hospice services; North Central Texas Services (d/b/a CareFlite) (CareFlite), a provider of helicopter, fixed wing and ground ambulance services; North Texas Health Care Laundry Cooperative Association (NTHC Laundry), a provider of laundry services; USMD Arlington and USMD Fort Worth, short-stay hospitals; Imaging Center Partnership, L.L.P. (d/b/a Southwest Diagnostic Imaging Center) (SDIC), a provider of outpatient diagnostic imaging services; Texas Health Huguley, Inc. (d/b/a Texas Health Huguley Hospital Fort Worth South) (Huguley), an acute care hospital; 14 ambulatory surgery centers; two endoscopy centers; and other joint ventures.

On May 25, 2016, THR announced the creation of a jointly owned health plan company with Aetna (Aetna Health). THR is acquiring a 50% interest in approximately 100,000 commercial lives, and expects to invest between $75,000,000 and $110,000,000 in the joint venture. New fully-insured and self-insured commercial products will be offered to employers and consumers in 16 counties in North Texas and are anticipated to begin being introduced in 2017, pending regulatory approval. Aetna will provide administrative services.

On May 10, 2016, THR and Adeptus Health Inc. (Adeptus Health) formed a joint venture to increase access to high quality, convenient emergency medical care in the Dallas-Fort Worth area. Under the joint venture, Adeptus Health's freestanding First Choice Emergency Rooms in North Texas, and its First Texas Hospital in Carrollton, aligned with THR to grow THR's network of hospitals and outpatient centers. As of December 31, 2016, THR had not contributed any cash to this joint venture.

On December 15, 2015, Texas Health Resources formed an integrated regional health network with The University of Texas Southwestern Medical Center (UTSW). This new network, Southwestern Health Resources (SWHR), is expected to offer key advantages for patients in North Texas including: a) a broad, integrated continuum of physician-driven care utilizing UTSW's network of faculty and community-based physicians, THR's employed physicians, and independent physicians affiliated with both organizations; and b) an integrated hospital network consisting of UTSW's two university hospitals and THR's wholly-controlled and joint-ventured community hospitals, a key component of which is a new organization – a Joint Operating Company formed to integrate the three Dallas hospitals (UTSW's William P. Clements Jr. University Hospital and Zale Lipshy University Hospital, and Texas Health Presbyterian Hospital Dallas). The new health network (SWHR Network) commenced activities on April 1, 2016, and THR recorded its share of net operations in 2016 with the majority of capital funding expected to commence in 2017. In conjunction with this arrangement, THR and UTSW entered into an Academic Affiliation Agreement in which THR committed to fund a maximum of $28,500,000 annually and not to exceed $140,000,000 over five years in support of medical education and research programs that benefit SWHR Network. This commitment is subject to certain conditions including THR achieving a minimum level of annual financial performance.

18. Investments in Unconsolidated Affiliates, continued

The ownership interests, carrying amounts, and equity in earnings of investments in unconsolidated affiliates at December 31, 2016 and 2015 were as follows (dollars in thousands):

	Ownership Interest		Carrying Value		Equity in Earnings	
	2016	2015	2016	2015	2016	2015
Surgery Centers	51.0% - 84.0%	51.0% - 80.3%	$ 69,447	$ 54,768	$ 38,281	$ 31,273
Huguley	51.0%	51.0%	58,648	51,760	6,888	8,888
USMD Arlington	51.0%	51.0%	28,062	28,307	11,264	10,539
Endoscopy Centers	51.0%	51.0%	24,455	25,253	9,086	9,897
Hospice	50.0%	50.0%	21,557	20,152	1,404	385
USMD Fort Worth	51.0%	51.0%	14,739	12,836	2,354	1,148
CareFlite	50.0%	50.0%	7,137	9,549	(2,412)	843
NTHC Laundry	45.6%	45.6%	5,441	5,031	484	473
Aetna Health	50.0%	0.0%	2,500	-	(2,500)	-
SDIC	50.0%	50.0%	1,982	1,634	3,146	3,661
SWHR Network	49.0% - 51.0%	0.0%	(11,229)	-	(11,730)	-
Others	1.2% - 30.0%	1.2% - 30.0%	1,761	1,428	3,699	1,668
			$ 224,500	$ 210,718	$ 59,964	$ 68,775

The equity in earnings of unconsolidated affiliates providing services that the System does not provide as part of its routine services are included in nonoperating gains (losses) in the accompanying consolidated statements of operations and changes in net assets. All others are included in operating revenue.

19. Related-Party Transactions

THR incurred expenses for purchased services from NTHC Laundry of approximately $9,786,000 and $9,782,000 for the years ended December 31, 2016 and 2015, respectively, which is recorded in other operating expenses in the accompanying consolidated statements of operations and changes in net assets. Amounts due to NTHC Laundry, which total approximately $838,000 and $988,000 at December 31, 2016 and 2015, respectively, are reflected in current liabilities in the accompanying consolidated balance sheets. THR recorded management services and purchased workforce revenue from SWHR Network totaling approximately $8,239,000 for the year ended December 31, 2016, which is recorded in other operating revenue in the accompanying consolidated statements of operations and changes in net assets. Amounts due from SWHR Network, which total approximately $5,626,000 at December 31, 2016, are reflected in other receivables in the accompanying consolidated balance sheets. Additionally, THR has various other immaterial transactions with certain of its nonconsolidated affiliates throughout the year.

20. Subsequent Events

The System evaluated events subsequent to December 31, 2016 and through April 14, 2017, the date on which the financial statements were issued.