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CONSOLIDATED FINANCIAL STATEMENTS AND OTHER FINANCIAL INFORMATION

CHRISTUS Health
Years Ended June 30, 2008 and 2007

CHRISTUS Health

Consolidated Financial Statements and Other Financial Information

Years Ended June 30, 2008 and 2007

Contents

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Independent Auditors' Report

The Board of Directors
CHRISTUS Health

We have audited the accompanying statement of financial position of CHRISTUS Health as of June 30, 2008 and 2007, and the related statements of operations and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of CHRISTUS Health's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of CHRISTUS Health's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of CHRISTUS Health's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of CHRISTUS Health as of June 30, 2008 and 2007, and the results of its consolidated operations and changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

As discussed in Note 10 to the consolidated financial statements, effective June 30, 2007, CHRISTUS Health changed its method of accounting for its defined benefit pension plans.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 11, 2008, on our consideration of CHRISTUS Health's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Ernst + Young LLP

September 11, 2008

CHRISTUS HEALTH

CONSOLIDATED BALANCE SHEETS
AS OF JUNE 30, 2008 AND 2007
(In thousands)

	2008	2007
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 174,474	$ 246,730
Short-term investments	277,738	408,935
Equity investments in managed funds	315,262	349,847
Assets whose use is limited or restricted, required for current liabilities	55,245	56,355
Patient accounts receivable, net of allowance for uncompensated care of $192,195 and $159,946 at June 30, 2008 and 2007, respectively	375,705	329,706
Estimated third-party payor settlements	2,371	2,773
Notes and other receivables	154,503	49,956
Inventories	83,017	74,794
Assets held for sale	2,021	-
Securities pledged to creditors	36,502	91,918
Security lending collateral	39,789	95,327
Other current assets	31,291	27,658
Total current assets	1,547,918	1,733,999
ASSETS WHOSE USE IS LIMITED OR RESTRICTED—Less current portion	690,719	473,699
PROPERTY, PLANT, AND EQUIPMENT—Net of accumulated depreciation	1,921,396	1,720,088
OTHER ASSETS:		
Investments in unconsolidated organizations	181,337	168,435
Derivative investments	2,941	34,883
Goodwill, net of amortization	119,387	59,972
Other assets	86,315	81,614
Other restricted assets	27,366	24,500
Total other assets	417,346	369,404
TOTAL	$ 4,577,379	$ 4,297,190

CHRISTUS HEALTH

CONSOLIDATED BALANCE SHEETS
AS OF JUNE 30, 2008 AND 2007
(In thousands)

	2008	2007
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES:		
Accounts payable and accrued expenses	$ 373,241	$ 309,484
Accrued employee compensation and benefits	140,987	113,846
Accrued pension benefits	3,551	8,830
Estimated third-party payor settlements	14,332	28,665
Current portion of long-term debt	30,306	22,811
Payable under security lending agreements	39,789	95,327
Long term obligations subject to remarketing agreements	138,535	39,352
Total current liabilities	740,741	618,315
LONG-TERM DEBT—less current portion	1,097,381	875,799
ACCRUED PENSION BENEFITS—less current portion	86,614	59,499
OTHER LONG-TERM OBLIGATIONS—Primarily related to self-funded liabilities—less current portion	136,027	143,744
Total liabilities	2,060,763	1,697,357
MINORITY INTEREST	78,021	16,899
COMMITMENTS AND CONTINGENCIES		
NET ASSETS:		
Unrestricted	2,372,539	2,522,843
Temporarily restricted	52,939	45,484
Permanently restricted	13,117	14,607
Total net assets	2,438,595	2,582,934
TOTAL	$ 4,577,379	$ 4,297,190

See accompanying notes.

CHRISTUS HEALTH

CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2008 AND 2007
(In thousands)

	2008	2007
UNRESTRICTED REVENUES, GAINS, AND OTHER SUPPORT:		
Net patient service revenue	$ 2,806,809	$ 2,405,460
Premium revenue	147,874	136,361
Other revenue	186,468	196,531
Equity in income of unconsolidated organizations	26,312	23,620
Total revenues, gains, and other support	3,167,463	2,761,972
EXPENSES:		
Employee compensation and benefits	1,398,001	1,269,263
Services and other	818,168	712,921
Supplies	516,996	472,564
Depreciation and amortization	216,846	181,729
Provision for uncollectible accounts	174,069	118,187
Interest	52,600	31,607
Total expenses	3,176,680	2,786,271
OPERATING LOSS	(9,217)	(24,299)
NONOPERATING INVESTMENT (LOSS) INCOME	(98,476)	172,675
NONOPERATING LOSS	(1,155)	(4,128)
REVENUES IN (DEFICIT) EXCESS OF EXPENSES	(108,848)	144,248

(Continued)

CHRISTUS HEALTH

CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2008 AND 2007
(In thousands)

	2008	2007
NET INCOME FROM DISCONTINUED OPERATIONS, Net of gain on sale of St. Joseph Health System-Paris, TX of $20 and $2,000 in fiscal years 2008 and 2007, and net gain on St. Joseph-Houston of $7,816 for fiscal year 2007	$ 20	$ 9,816
OTHER CHANGES IN UNRESTRICTED NET ASSETS:		
Net change in unrealized (loss) gain on investments	(9,470)	3,090
Changes to pension liabilities	(37,842)	73,465
Other	5,836	12,234
CHANGES IN UNRESTRICTED NET ASSETS BEFORE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE	(150,304)	242,853
EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE	-	(75,578)
CHANGES IN UNRESTRICTED NET ASSETS	(150,304)	167,275
TEMPORARILY RESTRICTED NET ASSETS:		
Contributions	17,458	5,229
Net change in unrealized gain (loss) on investments	(1,527)	67
Net assets released from restrictions and other	(8,476)	(3,315)
CHANGES IN TEMPORARILY RESTRICTED NET ASSETS	7,455	1,981
CHANGES IN PERMANENTLY RESTRICTED NET ASSETS	(1,490)	3,775
CHANGES IN NET ASSETS	(144,339)	173,031
NET ASSETS—Beginning of year	2,582,934	2,409,903
NET ASSETS—End of year	$ 2,438,595	$ 2,582,934

See accompanying notes. (Concluded)

CHRISTUS HEALTH

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2008 AND 2007
(In thousands)

	2008	2007
OPERATING ACTIVITIES:		
Changes in net assets	$ (144,339)	$ 173,031
Adjustments to reconcile changes in net assets to net cash (used in) provided by operating activities:		
Cumulative effect of a change in accounting principle	-	75,578
Change in pension liabilities	27,115	(73,465)
Other changes in net assets	(17,458)	(5,228)
Equity in income of unconsolidated organizations	(26,312)	(23,619)
Equity earnings on investments in managed funds	(15,965)	(52,906)
Depreciation and amortization	216,846	181,729
Provision for uncollectible accounts	174,069	118,187
Change in swap fair value	53,828	(4,431)
Changes in operating assets and liabilities, net of acquisitions:		
Net patient accounts receivable	(186,140)	(77,374)
Investments classified as trading	(48,326)	42,952
Notes and other receivables	(104,546)	6,547
Inventories	(1,896)	(5,772)
Other current assets	(3,397)	324
Accounts payable, accrued expenses, and accrued employee compensation and benefits	63,649	(9,536)
Net third-party payor settlements	(19,332)	8,621
Liability for self-funded liabilities	(38,423)	(6,298)
Net operating cash flows pertaining to assets held for sale	-	(25,273)
Net cash (used in) provided by operating activities	(70,627)	323,067
INVESTING ACTIVITIES:		
Purchases of property, plant, and equipment	(247,208)	(286,805)
Proceeds from sale or disposal of property, plant, and equipment	1,459	3,797
Decrease in equity investments in managed funds	50,550	6,127
Decrease (increase) in investments in unconsolidated organizations	15,510	(24,165)
Decrease (increase) in securities pledged to creditors	55,416	(29,738)
Increase in other assets	(14,437)	(21,985)
Decrease (increase) in security lending collateral	55,538	(31,093)
Acquisitions of health care entities, net of cash acquired	(151,908)	-
Net investing cash flows pertaining to assets held for sale	-	145,662
Net cash used in investing activities	(235,080)	(238,200)

(Continued)

CHRISTUS HEALTH

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2008 AND 2007
(In thousands)

	2008	2007
FINANCING ACTIVITIES:		
Contributions of temporarily restricted net assets	$ 17,458	$ 5,228
Other costs associated with debt refinancing	303	-
Proceeds from debt issuance	293,160	-
Payments on long-term debt	(21,932)	(30,057)
(Decrease) increase in payable under security lending agreements	(55,538)	31,093
Net cash provided by financing activities	233,451	6,264
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(72,256)	91,131
CASH AND CASH EQUIVALENTS—Beginning of year	246,730	155,599
CASH AND CASH EQUIVALENTS—End of year	$ 174,474	$ 246,730
NONCASH INVESTING AND FINANCING TRANSACTIONS:		
Capital lease obligations incurred	$ 11,684	$ -
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION—Cash paid during the year for interest (net of amount capitalized)	$ 51,792	$ 31,108

See accompanying notes.

(Concluded)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

AS OF AND FOR THE YEARS ENDED JUNE 30, 2008 AND JUNE 30, 2007

1. MISSION, VISION, AND ORGANIZATION OF CHRISTUS HEALTH

CHRISTUS Health (CHRISTUS) was incorporated as a Texas nonprofit corporation on December 15, 1998. CHRISTUS Health is sponsored by the Congregation of the Sisters of Charity of the Incarnate Word of Houston, Texas, and the Congregation of the Sisters of the Incarnate Word of San Antonio, Texas. The Congregation of the Sisters of Charity of the Incarnate Word of Houston, Texas, sponsors the Sisters of Charity Health Care System (SCH), and the Congregation of the Sisters of Charity of the Incarnate Word of San Antonio, Texas, sponsors the Incarnate Word Health System (IWHS). SCH and IWHS continue to exist and carry out their ministries.

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

The vision of CHRISTUS Health is to be a leader and advocate in creating exemplary health care services, processes, and structures that improve the health of individuals and of local and global communities so all may experience God's healing presence and love.

The consolidated financial statements of CHRISTUS Health include activities of its affiliated market-based organizations and other related entities, all of which are wholly or majority owned and commonly referred to as regions or entities. For purposes of these consolidated financial statements, the "System" is defined as CHRISTUS Health's affiliated market-based organizations and other related entities. The other related entities include, but are not limited to, hospital foundations, professional office buildings, management services organizations, physician groups, a collection agency, self-insurance trusts, an offshore captive insurance company, a health plan, integrated community health networks, and diagnostic imaging companies.

1. MISSION, VISION, AND ORGANIZATION OF CHRISTUS HEALTH (Continued)

Certain entities of CHRISTUS Health, otherwise included in the consolidated financial statements of CHRISTUS Health, are excluded from the CHRISTUS Health Obligated Group. These entities include, but are not limited to, the CHRISTUS Health Liability Retention Trust, Emerald Assurance, CHRISTUS St. Vincent Regional Medical Center, CHRISTUS Health Utah, Dubuis Health System, C.H. Wilkinson Physician Network, CHRISTUS HomeCare, CHRISTUS Muguerza, S.A. de C.V., and various philanthropic foundations.

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

2. COMMUNITY HEALTH

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

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

Charity Care- in accordance with the Catholic Health Association (CHA) guidelines, charity care represents the unpaid costs of free or discounted health services provided to persons who cannot afford to pay and who meet the organization's criteria for financial assistance.

Traditional charity care is defined by the State of Texas as the unreimbursed costs of providing, funding, or otherwise financially supporting the health care services provided to a person with income at or below 200% of the federal poverty level. Charity care services provided to these patients are not reported as revenue in the consolidated statements of operations and changes in net assets as there is minimal or no expectation of payment.

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

2. COMMUNITY HEALTH (Continued)

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

Examples of CHRISTUS Health Community Benefits accounted for under Community Services for the Poor and Underserved include-

The CHRISTUS Community Direct Investment Program (CDI) was established to support community-driven initiatives primarily for affordable housing and economic development by providing financing at below market interest rates. The majority of the support is provided to programs in the CHRISTUS operating regions. The amount the System would have earned on these monies is the forgone income that is considered a community benefit.

The CHRISTUS Fund was established for the purpose of providing grants to support community planning, healthy community initiatives, and community-based programs with a focus on the poor and underserved areas where CHRISTUS Health ministries and sponsoring congregations are involved.

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

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

Other Community Services- represent leadership activities, community planning, and advocacy.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

Use of Estimates- The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management of the System to make assumptions, estimates, and judgments that affect the amounts reported in the financial statements, including the notes thereto, and related disclosures of commitments and contingencies, if any. The System considers critical accounting policies to be those that require more significant judgments and estimates in the preparation of its financial statements, including the following: recognition of net patient revenues, which includes contractual allowances; provisions for bad debt; reserves for losses and expenses related to health care professional and general liabilities; determination of fair values of certain financial instruments; risks and assumptions for measurement of pension and retiree medical liabilities. Management relies on historical experience and on other assumptions believed to be reasonable under the circumstances in making its judgments and estimates. Actual results could differ materially from these estimates.

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

Investments and Derivative Financial Instruments- Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value (both based on quoted market prices when available) in the consolidated balance sheets. Investments also include equity investments in managed funds structured as limited liability corporations or partnerships. These investments are accounted for under the equity method.

Investment income or loss (including equity investment earnings on managed funds; realized and unrealized gains and losses, computed on the average-cost basis of the security at the time of sale; and interest and dividends) is included in revenues in (deficit) excess of expenses unless the income or loss is restricted by donor or law.

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

Additionally, the System periodically utilizes various derivative financial instruments (e.g., interest rate swaps) to hedge interest rate and other exposures. Changes in the fair value of the System's interest rate swaps are recorded as a separate component of nonoperating investment (loss) income in the consolidated statements of operations and changes in net assets.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

Property, Plant, and Equipment- Property, plant, and equipment acquisitions are recorded at cost or fair market value at the time of donation. Expenditures, which materially increase values, change capacities, or extend useful lives, are capitalized. Routine maintenance, repairs, and minor equipment replacement costs are charged against operations.

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

Asset Impairment- The System periodically evaluates the carrying value of its long-lived assets for impairment when indicators of impairment are identified. These evaluations are primarily based on the estimated recoverability of the assets' carrying value.

Investments in Unconsolidated Organizations- The System has investments in certain organizations of which the System does not have a majority-ownership interest that do not require consolidation. These investments are recorded using the equity method of accounting.

Securities Lending- The System participates in securities lending transactions facilitated by the lending agent. Such loans are secured by collateral of 102% of the market value of domestic securities and 105% of the market value of foreign securities. Such collateral will typically be cash or debt securities issued by the U.S. Government or any of its agencies. Cash collateral received in connection with these loans is invested in a short-term pooled fund maintained by the lending agent.

Goodwill- The cost over the fair value of net assets acquired is amortized on a straight-line basis over 5 to 40 years depending on the asset. The System reviews goodwill on a periodic basis to determine if impairment has occurred. An impairment is deemed to have occurred if the expected cash flows from continuing to use the asset are less than the carrying value of the asset. Any such impairment is recorded in operations. No goodwill impairment was recorded in fiscal year 2008 or 2007. Goodwill is recorded net of accumulated amortization of $27,557,000 and $19,584,000 at June 30, 2008 and 2007, respectively.

Deferred Financing Costs- Deferred financing costs, net of accumulated amortization, included in other assets at June 30, 2008 and 2007, are $24,396,000 and $18,692,000, respectively, which are being amortized, using the interest method, over the terms of the indebtedness to which they relate.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Temporary and Permanently Restricted Net Assets- Temporarily restricted net assets are those whose use by the System has been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by the System in perpetuity.

Patient Accounts Receivable, Estimated Payables to Third-Party Payors, and Net Patient Service Revenue- The System has agreements with third-party payors that provide for payments to the System at amounts different from established rates. Patient accounts receivable and net patient service revenue are reported at the estimated net realizable amounts from third-party payors, and others for services rendered. Estimated retroactive adjustments under reimbursement agreements with third-party payors are included in net patient service revenue and estimated payables to 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.

During fiscal year 2007, the System implemented an uncompensated care policy whereby revenue from services provided to the uninsured is recognized at the time of payment rather than the time of service. This policy is a result of the lack of reasonable assurance of collection for services provided to the uninsured due to the System's historically low collection rate. Management has estimated that the difference between recording this revenue on the cash basis versus the accrual basis to be immaterial to net patient service revenue for fiscal years 2008 and 2007. Accordingly, all accounts receivable from the uninsured have been fully reserved in the allowance for uncompensated care. The resulting adjustment is recorded as revenue deductions from gross charges to arrive at net patient service revenue.

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

Premium Revenue and Associated Costs- Premium revenue represents revenues derived under capitated arrangements with third parties. In return for these premiums, the contracting entity is responsible for providing essentially all health care services to enrolled participants. Costs for providing these services, including services provided by other health care providers, are included as operating expenses in the consolidated financial statements. At June 30, 2008 and 2007, the respective contracting entities have accrued expenses for incurred but not reported claims based upon claims experience. The contracting entities maintain stop-loss insurance coverage to limit exposure for certain catastrophic claims.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Other Revenue- Other revenue is derived from services other than providing health care services or coverage to patients, residents, or enrollees. These typically include investment income from all funds held by a trustee, malpractice funds, or other miscellaneous investment activities; rental of health care facility space; sales of medical and pharmaceutical supplies to employees, physicians, and others; proceeds from sale of cafeteria meals and guest trays to employees, medical staff, and visitors; and proceeds from sales at gift shops, snack bars, newsstands, parking lots, vending machines, or other service facilities operated by the health care organization.

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

International Operations- The System owns a 51% interest in CHRISTUS Muguerza, S.A. de C.V. (CHRISTUS Muguerza), headquartered in Monterrey, Mexico. CHRISTUS Muguerza is a private health care system and is subject to taxes in accordance with the regulations of the country of Mexico. All profits of CHRISTUS Muguerza are reinvested. The financial statements of CHRISTUS Muguerza are presented in accordance with accounting principles generally accepted in the United States and are consolidated in the CHRISTUS Health financial statements. Also during the fourth quarter of 2008, a reclassification of $11,711,000 was made between net assets and minority interest liability to correctly reflect the liability at June 30, 2008.

Subsequent to June 30, 2008, the System increased the ownership interest in CHRISTUS Muguerza by purchasing additional shares through the forgiveness of a portion of intercompany debt. The System also exchanged their shares in CHRISTUS Muguerza Sistemas Hospitalarios for additional CHRISTUS Muguerza shares. The transactions, which were executed on August 21, 2008, increased the System's ownership interest in CHRISTUS Muguerza to 56.77%.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Minimum Revenue Guarantees- CHRISTUS enters into agreements with non-employed physicians that include minimum revenue guarantees. These guarantees primarily arise through physician recruiting efforts and vary by physician specialty. Generally, the term of these guarantees ranges from one to two years with the majority including a forgiveness period that begins during the second year of the guarantees. The estimated amount of the liability for CHRISTUS' obligation under these guarantees was $6,635,000 and $2,492,000 at June 30, 2008 and 2007, respectively, and is included in other current liabilities in the accompanying consolidated balance sheets.

The maximum amount of future payments that the System could be required to make under existing guarantees is approximately $18,623,000, which also includes the remaining amount of guarantees that were entered into prior to the adoption of FSP FIN 45-3, *Application of Interpretation No. 45 to Minimum Revenue Guarantees Granted to a Business or its Owners.*

Asset Retirement Obligations- CHRISTUS estimates the conditional asset retirement obligation primarily associated with asbestos abatement to be $7,576,000 and $7,558,000 as of June 30, 2008 and 2007, respectively.

Uncertainty in Income Taxes- In July 2006, FASB Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109,* was issued. FIN 48 creates a single model to address uncertainty in tax positions and clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. Under the requirements of FIN 48, tax-exempt organizations could now be required to record an obligation as the result of a tax position they have historically taken on various tax exposure items. Prior to FIN 48, tax liabilities were recorded as incurred. On July 1, 2007, CHRISTUS Health adopted FIN 48 and the adoption had no impact on its financial statements. There are no material unrecorded tax liabilities as of June 30, 2008.

New Accounting Pronouncements- The FASB issued Statement No. 157, *Fair Value Measurements* (FAS 157), in September 2006. FAS 157 provides enhanced guidance for using fair value to measure assets and liabilities. FAS 157 also requires expanded disclosure about the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurement on earnings. In February 2007, the FASB issued Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (FAS 159), which allows entities to voluntarily choose, at specified election dates, to measure many financial assets and financial liabilities (as well as certain nonfinancial instruments that are similar to financial instruments) at fair value. The election is made on an instrument-by-instrument basis and is irrevocable. If the fair value option is elected for an instrument, FAS 159 specifies that all subsequent changes in fair value be reported in earnings.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

FAS 157 and FAS 159 are effective for fiscal years beginning after November 15, 2007. The System does not anticipate the adoption of FAS 157 will have a significant effect on the consolidated financial statements. The System is evaluating the impact, if any, of adoption of FAS 159.

Reclassifications- Certain amounts have been reclassified in the prior year's financial statements to conform to the classifications used in the current year.

Approximately $39,352,000 of variable rate demand bonds that were included in long-term debt in the prior-year financial statements have been reclassified to long-term debt obligations subject to remarketing agreements within current liabilities to conform with the current-year presentation.

Approximately $91,918,000 of securities on loan related to the securities lending program that were included in Short Term and Other Investments in the prior-year financial statements have been reclassified to securities pledged to creditors to conform with the current-year presentation.

4. NET PATIENT SERVICE REVENUE

Net patient service revenue is reported at the estimated net realizable amounts from third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Amounts subject to retroactive adjustments are estimated and recorded in the period the related services are rendered and adjusted in future periods as final settlements are determined. The estimated settlements recorded at June 30, 2008 and 2007, could differ from actual settlements. Inpatient acute care services and outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to a patient diagnosis related group classification system that is based on clinical, diagnostic, and other factors.

Inpatient and outpatient services rendered to Medicaid program beneficiaries are paid under cost reimbursement methodologies, prospectively determined rates per discharge, and prospectively determined or negotiated rates.

Revenue from the Medicare and Medicaid programs accounted for approximately 30.1% and 7.0%, respectively, of the System's net patient revenue for the fiscal year ended 2008 and 33.9% and 9.0%, respectively, of the System's net patient revenue for the fiscal year ended 2007. 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.

4. NET PATIENT SERVICE REVENUE (Continued)

The System has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment to the System under these agreements includes prospectively determined rates per discharge, discounts from established charges, and negotiated daily rates.

In July 1991, the Texas Legislature passed a bill authorizing a state program (Medicaid Dispro), whereby all hospitals in the State of Texas that qualified as a disproportionate share health care provider would receive Medicaid Dispro funds. This program, with certain revisions, was extended through August 31, 2008, and is administered by the Texas Department of Health. In 1993, the Texas Legislature expanded the number of hospitals qualifying to receive Medicaid Dispro funds to include rural facilities. The source of these funds is assessments from qualifying hospitals that are matched at a specific percentage by the federal government.

Additionally, the federal Medicaid rules allow for hospitals to be reimbursed for some of the uncompensated cost of treating Medicaid and uninsured patients up to an Upper Payment Limit (UPL). UPL programs act as mechanisms to draw federal Medicaid dollars into local communities. The Texas Medicaid program has chosen a county-specific UPL strategy to receive supplemental federal matching funds. Under these programs various hospital participants in the respective counties have elected to provide health care services to the indigent population in the county as charity services and, as such, no third party has an obligation to pay for these services. Separately, and with no legal obligation or link to the hospitals' provision of charity services, the tax-supported governmental entity may choose, entirely at its discretion, to contribute a portion of its tax revenues into the State's Medicaid program. The amounts transferred by the governmental entity to the state Medicaid program are then matched at the federal level and the total amount (the amount transferred to the state Medicaid program by the governmental entity and the related federal match) is then paid to the hospital participants based upon each hospital's individual applicable funding entitlement. In addition to the allocations received by the Medicaid program, hospital participants in some communities may make charity community benefit transfers to each other throughout the year to reach a previously agreed-upon sharing ratio.

Medicaid supplemental payments, which include Medicaid Dispro and UPL payments, net of assessments and amounts transferred between program participants, of approximately $202,860,000 and $126,500,000 were recorded in 2008 and 2007, respectively. Approximately $92,090,000 of the fiscal year 2008 total relates to the State of Texas fiscal year Upper Payment Limit program and was recorded in the fourth quarter once it was determined that the program deferment was released. Net patient service revenue in the accompanying consolidated statements of operations and changes in net assets includes all Medicaid supplemental funds as a reduction of contractual allowances. The amounts of future reimbursements under these programs cannot be assured beyond the state's fiscal year 2008.

4. NET PATIENT SERVICE REVENUE (Continued)

Fiscal years 2008 and 2007 net patient service revenue increased approximately $14,417,000 and $8,344,000, respectively, related to changes in estimates for cost report re-openings, appeals, and tentative and final cost report settlements on filed cost reports, of which some are still subject to audit, additional re-opening, and/or appeal.

The health care industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, participation requirements of government health care programs, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Government activity has continued with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by health care providers. Violations of these laws and regulations could result in expulsion from government health care programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. There are matters currently under audit and/or review by regulatory and government officials. These reviews and audits may or may not result in revisions to cost reports, resubmitted billings, unasserted possible claims that are probable of assertion, or loss contingencies. Compliance with such laws and regulations may be subject to future government review and interpretation, as well as regulatory actions.

5. CASH AND INVESTMENTS

	In Thousands	
	2008	**2007**
Cash and cash equivalents	$ 476,439	$ 343,885
United States government obligations	154,611	121,498
Corporate obligations	156,530	175,496
Marketable equity securities	338,760	514,422
Equity in managed funds	352,337	389,997
Other investments	71,263	82,186
	$ 1,549,940	$ 1,627,484

Cash and cash equivalents include cash, money-market bank accounts, interest-bearing bank accounts, and debt securities with maturities less than three months. United States government obligations include debt securities issued by the United States government or a United States government agency. Corporate obligations include debt securities and certificates of deposit greater than three months. Marketable equity securities include domestic and foreign stocks. Equity in managed funds includes investments in limited liability partnerships or corporations and other alternative investments, also referred to as hedge funds. Other investments include municipal and foreign fixed-income instruments and restricted investments held by the System's philanthropic foundations.

5. CASH AND INVESTMENTS (Continued)

Investments in marketable securities, certain mutual funds, and exchange-traded funds with readily determinable fair values are reported at fair value based on quoted market values. Investments in managed funds do not have readily determinable fair values and are recorded based on the System's share of the underlying value of portfolio securities held by these funds, as reported to the System. The investments in managed funds are accounted for under the equity method of accounting. Under this method, the equity in earnings includes changes in reported values in the underlying investments. Reported values cannot be validated by the management of the System, reported values may not be reliable, and there can be no assurance such reported amounts will be ultimately realized.

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

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

Equities- This investment class is comprised primarily of common equity securities of domestic companies. These securities trade through the major public domestic and international exchanges. This investment class also includes investments in common trust funds, mutual funds, and exchange-traded funds that hold investments in equity securities. The equity securities investments are exposed to various risks including market risk, individual security risk, foreign exchange risk, and, for common equity of companies with a small market capitalization, liquidity risk.

Equity investments in managed funds- These funds are invested with external investment managers who invest primarily in various alternative categories, including long and short equity positions, managed futures, emerging markets, distressed enterprises, and arbitrage positions. These investments are domestic and international in nature, are illiquid, and may not be realized for a period of several years after the investments are made. The risks associated with these investments are numerous resulting in a greater likelihood of losing invested capital. The risks include the following:

> Nonregulation risk- They are not required to register with the SEC and are not subject to regulatory controls.
>
> Managerial risk- Fund managers may fail to produce the intended returns and are not subject to oversight.

5. CASH AND INVESTMENTS (Continued)

Minimal liquidity- Many funds impose lock-up periods that prevent investors from redeeming their shares or impose penalties to redeem.

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

Investment strategy risk- The funds often employ sophisticated, risky investment strategies and are speculative and may use leverage, which could result in volatile returns.

Due to the inherent volatility in the investment markets, there is at least a reasonable possibility that recorded investment values may change by a material amount in the near term.

The System has no commitments for funding to equity investments in managed funds as of June 30, 2008.

Assets whose use is limited or restricted consisted of the following at June 30, 2008 and 2007 (in thousands):

	2008	2007
Other investments, internally designated for capital expansion and other purposes	$ 297,942	$ 204,344
Under bond indenture agreement - held by trustee	232,438	87,492
Under liability retention and self-insurance funding arrangement - held by trustee	215	3,334
Under Emerald Assurance funding arrangements	120,280	137,162
Restricted cash and investments	39,844	41,367
Total assets whose use is limited or restricted - less current portion	$ 690,719	$ 473,699

5. CASH AND INVESTMENTS (Continued)

Investment return and gains for assets limited as to use, cash equivalents, and other investments consisted of the following for the years ended June 30, 2008 and 2007 (in thousands):

	2008	2007
Operating interest and dividend income	$ 19,377	$ 14,022
Operating realized gains	3,866	8,149
Equity investment earnings on managed funds	259	3,401
Net change in unrealized gain on investments	16	6,272
Total operating investment income	23,518	31,844
Nonoperating interest and dividend income	23,539	26,486
Nonoperating realized gains	32,214	44,555
Equity investment earnings on managed funds	15,706	49,505
Net change in unrealized (loss) gain on investments	(116,107)	47,698
Change in value of swap agreements	(53,828)	4,431
Total nonoperating investment (loss) income	(98,476)	172,675
Total investment (loss) income	$ (74,958)	$ 204,519

6. PROPERTY, PLANT, AND EQUIPMENT

Property, plant, and equipment at June 30, 2008 and 2007, consisted of the following (in thousands):

	2008	2007
Land	$ 226,287	$ 202,244
Land improvements	70,429	54,851
Buildings and fixed equipment	1,988,481	1,849,268
Major movable equipment	1,636,631	1,346,379
Less accumulated depreciation	(2,170,162)	(1,894,991)
	1,751,666	1,557,751
Construction-in-progress (estimated cost to complete is $324 million and $302 million at June 30, 2008 and 2007, respectively)	169,730	162,337
Total	$ 1,921,396	$ 1,720,088

Depreciation expense for the System for fiscal years 2008 and 2007 totaled $208,873,000 and $177,015,000, respectively.

7. INVESTMENTS IN UNCONSOLIDATED ORGANIZATIONS

The System has unrestricted investments in unconsolidated organizations of $181,337,000 and $168,435,000 at June 30, 2008 and 2007, respectively. The following investments account for 87% and 88% of the System's total investments in unconsolidated organizations in 2008 and 2007, respectively.

Baptist St. Anthony's Health System- CHRISTUS Health has a 50% membership interest in Baptist St. Anthony's Health System (BSAHS), a Texas nonprofit corporation. BSAHS is a market leader in the Amarillo area. CHRISTUS Health's recorded investment in BSAHS was $135,157,000 and $121,514,000 at June 30, 2008 and 2007, respectively. The 2008 balance includes $8,791,000 of restricted net assets that are included in other restricted assets. CHRISTUS Health recorded its share of BSAHS's income from operations of $14,783,000 and $15,425,000 in 2008 and 2007, respectively. The System also recorded its share of the change in unrealized losses on investments of $5,826,000 and the change in unrealized gains on investments of $1,586,000 at June 30, 2008 and 2007, respectively, as changes in unrestricted net assets. Additionally, the System has a note receivable from BSAHS resulting from the formation of the joint venture. At June 30, 2008 and 2007, the principal amount of the note receivable was $10,660,000 and $10,983,000, respectively, and is included in notes and other receivables in the consolidated balance sheets. Principal and interest payments are made on a quarterly basis. The annual interest rate is 6.13%.

7. INVESTMENTS IN UNCONSOLIDATED ORGANIZATIONS (Continued)

Preferred Professional Insurance Company- CHRISTUS Health has an 11.8% ownership interest in Preferred Providers Insurance Company (PPIC), a taxable Nebraska corporation. This corporation, formed in 1988, was established to provide excess professional and general liability insurance. CHRISTUS Health's recorded investment in PPIC was $16,739,000 and $12,975,000 at June 30, 2008 and 2007, respectively. The System recorded its share of PPIC's income from operations in fiscal years 2008 and 2007 of $3,957,000 and $2,331,000, respectively.

CS/USP Surgery Centers, L.P.- During fiscal year 2007, CHRISTUS Spohn Health System Corporation entered into a 50% joint venture with United Surgical Partners International, Inc. (USP), to create a Texas limited liability partnership for the purpose of owning and operating ambulatory surgery centers in Corpus Christi, Texas. The initial venture is two surgery centers near the campus of Spohn Shoreline, specifically Corpus Christi Outpatient Surgery and SurgiCare. CHRISTUS Health's recorded investment was $6,077,000 and $6,229,000 at June 30, 2008 and 2007, respectively. The System recorded its share of income from operations in fiscal years 2008 and 2007 of $882,000 and $167,000, respectively.

Consolidated Catholic Casualty Risk Retention Group- CHRISTUS Health has a 23.2% ownership interest in Consolidated Catholic Casualty Risk Retention Group (CCCRRG), a tax-exempt Vermont corporation. This corporation, formed in 1987, was established to provide excess professional and general liability insurance. At June 30, 2008 and 2007, the System's recorded investment in CCCRRG was $5,164,000 and $4,593,000, respectively. The System recorded its share of CCCRRG's income from operations in fiscal years 2008 and 2007 of $591,000 and $996,000, respectively.

Omega Lab Joint Venture- CHRISTUS Health has a 40.0% ownership interest in Omega Lab Joint Venture. At June 30, 2008 and 2007, the System's recorded investment in Omega Lab JV was $2,873,000 and $2,377,000, respectively. The System recorded its share of Omega Lab JV income from operations in fiscal years 2008 and 2007 of $724,000 and $294,000, respectively.

8. LONG-TERM DEBT

Long-term debt at June 30, 2008 and 2007 consisted of the following (in thousands):

	2008	2007
Revenue bonds, in variable rate demand mode, with weighted average trading rates of 3.89% and 3.84% in fiscal 2008 and 2007, respectively, due beginning in 2022 through 2047.	$ 195,715	$ 416,625
Revenue bonds, in variable rate demand mode, that failed to remarket and were purchased by banks under liquidity agreements. The rates for bank bonds range between LIBOR and prime. The agreements provide for amortization periods of three to five years with full payment due in 2012 through 2013.	514,070	-
Revenue bonds, in auction mode, with weighted average interest rates of 4.20% and 3.53% in fiscal 2008 and 2007, respectively, due in 2031 and 2041.	379,300	379,300
Revenue bonds, in fixed rate mode, bearing interest from 4.3% to 5.5%	29,743	42,910
Capital lease payable to Nueces County Hospital District, bearing interest at a fixed rate of 6.9% with annual principal payments through 2026, secured by the assets of CHRISTUS Spohn Hospital Memorial	51,798	53,218
Capital lease payable to Bee County, bearing interest at a fixed rate of 6.0% with annual principal payments through 2030, secured by the assets of CHRISTUS Spohn Hospital Beeville	10,400	10,705
Other note and capital lease note obligations	62,335	34,229
Fair value of swap agreements	22,861	975
	1,266,222	937,962
Less current maturities on long term obligations		
Long term obligations subject to remarketing agreements	(138,535)	(39,352)
Less current portion	(30,306)	(22,811)
Total	$ 1,097,381	$ 875,799

8. LONG-TERM DEBT (Continued)

In November 2007, the System issued $293,160,000 in bonds consisting of Series 2007A, 2007B, and 2007C bonds (collectively, the Series 2007 Bonds). Of this amount, $287,047,000 is for new projects and $6,113,000 for the cost of insurance and issuance.

Pursuant to the CHRISTUS Health Master Trust Indenture, an Obligated Group was created that consists of eight CHRISTUS Health regions as follows: CHRISTUS Spohn Health System, CHRISTUS Health Gulf Coast, CHRISTUS Health Southeast Texas, CHRISTUS Santa Rosa Health Care Corporation, CHRISTUS Health Ark-La-Tex, CHRISTUS Health Northern Louisiana, CHRISTUS Health Central Louisiana, and CHRISTUS Health Southwestern Louisiana. CHRISTUS Health is the Obligated Group Agent.

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

CHRISTUS Health established standby bond purchase agreements with three banks (the 2005 Agreements) to provide liquidity support for the 2005 series variable rate demand bonds. The 2005 Agreements provide for the banks to purchase up to $416,625,000 of the variable rate demand bonds. The 2005 Agreements call for facility fees of 0.16%, 0.175%, and 0.28% on variable rate debt of $123,420,000, $125,035,000, and $168,170,000, respectively. The expiration dates of the Agreements are November 8, 2008, November 8, 2010, and November 8, 2009. As of June 30, 2008, bonds purchased under the 2005 Agreements totaled $243,295,000, or $45,060,000, $101,715,000, and $96,520,000 under each respective agreement. As of August 31, 2008, bonds purchased under the 2005 Agreements had increased to a total of $268,795,000. The 2005 Agreements call for bank bond interest rates based on prime or LIBOR

In conjunction with the 2007 bond issue CHRISTUS Health established standby bond purchase agreements with two banks to provide liquidity support for the 2007 series variable rate demand bonds (The 2007 Agreements). The 2007 Agreements provide for the banks to purchase up to $293,160,000 of the variable rate demand bonds. The 2007 Agreements call for facility fees of 0.14% and 0.35% on variable rate debt of $ 180,000,000 and $113,160,000, respectively. The expiration dates of the Agreements are November 19, 2008 and November 20, 2014, respectively. As of June 30, 2008, bonds purchased under the 2007 Agreements totaled $270,775,000, or $163,615,000 and $107,160,000 under each respective agreement. As of August 31, 2008, bonds purchased under the 2007 Agreements had increased to a total of $285,890,000. The Agreements call for bank bond interest rates based on prime.

8. LONG-TERM DEBT (Continued)

The System has an obligation to make payments to the banks for unremarketed bonds purchased under the Agreements beginning subsequent to the termination of the Agreements. Based on the terms of the Agreements the total of the variable rate demand bonds that meet the criteria for classification as current liabilities is $138,535,000 and $39,352,000 as of June 30, 2008 and 2007, respectively. CHRISTUS anticipates completing a debt restructure transaction in fall 2008, which will include bank letter of credit support for all variable rate demand bonds in the portfolio. As a result, the current Agreements will not require renewal. CHRISTUS is currently seeking waivers of the repayment amortization provisions per the 2005 and 2007 Agreements, which will extend repayment requirements until after the close of the anticipated transaction.

Other long-term debt of approximately $62,335,000 includes long-term notes of approximately $44,829,000 entered into by CHRISTUS Muguerza, S.A. de C.V. to finance the expansion of the CHRISTUS Muguerza system through facility acquisition and construction and other routine capital expenditures. The interest rates on these long-term notes range from 8.83% to 12.25%. CHRISTUS Muguerza, S.A. de C.V. is not a member of the Obligated Group under the CHRISTUS Health Master Trust Indenture. The remaining long-term debt consists of capital leases assumed through acquisition of approximately $9,236,000 and other capital leases approximating $8,270,000.

Principal payments for all long-term debt for the next five years are as follows: 2009-$30,286,000; 2010-$43,795,000; 2011-$33,686,000; 2012-$19,209,000; 2013-$21,059,000; and thereafter-$1,118,187,000. In addition to the principal payments due in 2009, there is $40,073,000 due under the terms of the bond remarketing agreements.

9. DERIVATIVE FINANCIAL INSTRUMENTS

CHRISTUS Health has three swap agreements executed in July 2005, with cash flows beginning in November 2005. The aggregate notional amounts total $474,380,000. The counterparty to each agreement is Citibank, N.A., New York. The first swap agreement is in the notional amount of $225,925,000 (first swap agreement). The second swap agreement is in the notional amount of $53,420,000 (second swap agreement). The third swap agreement is in the notional amount of $195,035,000 (third swap agreement). FSA insures the first swap agreement. AMBAC insures the second and third swap agreements. Under these swaps agreements, CHRISTUS Health will pay to the swap counterparty amounts based upon a fixed rate and receive a floating rate based upon a taxable floating rate index (fixed payor). The forward swap agreements were entered into in July 2005 to hedge against rising interest rates and to lock in a fixed interest rate on variable rate bonds.

9. DERIVATIVE FINANCIAL INSTRUMENTS (Continued)

Under the terms of these agreements, CHRISTUS Health, as payor, will pay a fixed rate of 3.348% on the first and third swap agreements. Relative to the second swap agreement, CHRISTUS Health will pay a fixed rate of 4.447% through November 15, 2008, and thereafter will pay a fixed rate of 3.396% through July 1, 2022. Under the terms of the three agreements, CHRISTUS Health will receive a floating taxable rate equivalent to 64.50% of USD-LIBOR-BBA plus 0.15%. The termination date of the first and third swap agreements is July 1, 2031, and the termination date of the second swap agreement is July 1, 2022. The System may terminate and cash settle any of these swap agreements with at least two business days' notice to the counterparty. In accordance with the provisions of Statement of Financial Accounting Standards (SFAS) No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS No. 133), these swap agreements have been classified as derivative instruments, but the System has elected not to apply hedge accounting.

In fiscal year 2008 and 2007, the System paid and received interest of $2,288,000 and $1,724,000, respectively, related to the fixed payor swap agreements. This was recorded as an increase to and reduction in interest expense in 2008 and 2007, respectively. The fair value of the fixed payor swap agreements was reflected as a component of long-term debt in the amount of $4,882,000 at June 30, 2008, and a component of other assets in the amount of $23,284,000 at June 30, 2007, in the consolidated balance sheets. The change in value was recorded as a loss of $28,167,000 and $2,682,000 as a separate component of nonoperating investment (loss) income for the years ended June 30, 2008 and 2007, respectively, in accordance with SFAS No. 133.

The System currently has six basis swap agreements with notional amounts totaling $470,000,000. Each agreement has a 20-year term and matures at varying dates between December 2021 and November 2023. Under these agreements, CHRISTUS Health receives a floating taxable rate and pays a floating tax-exempt rate. These basis swap agreements do not qualify for hedge accounting in accordance with the provisions of SFAS No. 133; therefore, any income or loss generated from these swaps is recorded as operating investment income. In fiscal years 2008 and 2007, the System received interest of $1,612,000 and $2,411,000, respectively, related to these swap agreements. At June 30, 2008 and 2007, the fair value of these basis swaps was a liability of $298,000 and an asset of $11,599,000, respectively, and was recorded in the long-term portion of debt due others in 2008 and other assets in 2007 within the consolidated balance sheets. The change in value was recorded as a loss of $11,896,000 and a gain of $8,088,000 in a separate component of nonoperating investment (loss) income at June 30, 2008 and 2007, respectively in the consolidated statements of operations and changes in net assets, in accordance with SFAS No. 133.

In May 2007, CHRISTUS Health entered into a Constant Maturity swap with Citigroup as the counterparty in the notional amount of $200,000,000. This swap is effective on June 1, 2008 through June 1, 2022. Under the agreement, CHRISTUS pays 76.60% of one-month USA-LIBOR-BBA and receives 76.60% of the ten-year USA-LIBOR-BBA rate less .397%. In fiscal year 2008, the System accrued interest of $150,000 related to this swap agreement, which is

9. DERIVATIVE FINANCIAL INSTRUMENTS (Continued)

recorded as operating investment income. The fair value of this swap agreement was an asset of $2,941,000 and a liability of $975,000 at June 30, 2008 and 2007, respectively, which are recorded in other assets in 2008 and the long-term portion of debt due others in 2007 within the consolidated balance sheets. The change in value of $3,916,000 was recorded as a nonoperating investment gain during fiscal year 2008. During fiscal year 2007, the change in value was recorded as a loss of $975,000 in a separate component of nonoperating investment income in the consolidated statements of operations and changes in net assets, in accordance with SFAS No. 133.

In September 2007, CHRISTUS Health entered into two fixed payor swaps each with a notional amount of $83,050,000 for a total notional amount of $166,100,000. The swaps are both effective November 8, 2007, and terminate July 1, 2047. The counterparty to each agreement is Citibank, N.A., New York and is insured by MBIA. The forward swap agreements were entered into to hedge against rising interest rates and to lock in a fixed interest rate on variable rate bonds. Under the terms of these agreements, CHRISTUS Health, as payor, will pay a fixed rate of 3.688% and will receive a floating taxable rate equivalent to 61.7% of USD-LIBOR-BBA plus 0.26%. CHRISTUS Health paid interest of $1,368,000 related to the September 2007 fixed payor agreements. The System may terminate and cash settle these swap agreements with at least two business days' notice to the counterparty. The fair value of these fixed payor swap agreements was a liability of $10,906,000 at June 30, 2008, with a corresponding offset to a separate component of nonoperating investment loss in the consolidated statement of operations and changes in net assets, in accordance with the provisions of SFAS No. 133.

In October 2007, CHRISTUS Health entered into a fixed payor swap in the notional amount of $113,160,000. The swap is effective November 8, 2007, and terminates July 1, 2047. The counterparty to the agreement is Citibank, N.A., New York and is insured by MBIA. The forward swap agreement was entered into to hedge against rising interest rates and to lock in a fixed interest rate on variable rate bonds. Under the terms of these agreements, CHRISTUS Health, as payor, will pay a fixed rate of 3.705% and will receive a floating taxable rate equivalent to 61.7% of USD-LIBOR-BBA. CHRISTUS Health paid interest of $907,000 related to the November 2007 fixed payor agreement. The System may terminate and cash settle these swap agreements with at least two business days' notice to the counterparty. The fair value of this fixed payor swap agreement was a liability of $6,775,000 at June 30, 2008, with a corresponding offset to a separate component of nonoperating investment loss in the consolidated statement of operations and changes in net assets, in accordance with the provisions of SFAS No. 133.

10. CASH BALANCE PLAN AND POSTRETIREMENT HEALTH CARE BENEFITS

Cash Balance Plan- The System has established a noncontributory, defined-benefit retirement plan that operates as a cash balance plan and covers substantially all CHRISTUS Health employees who meet age and service requirements. The plan benefits are calculated based on a cash balance formula where participants earn an annual accrual of 6% of compensation, and participant account balances accrue interest at a rate that tracks ten-year treasury notes; maximum rate is 8%, minimum rate is 4%.

Postretirement Health Care Benefits- Comprehensive medical benefits are provided to eligible active employees who, immediately upon retirement and attainment of age 55, will receive a pension under the CHRISTUS Health retirement plan. Postretirement benefits are also provided to former employees who are currently receiving pension benefits. The comprehensive medical program, which is self-insured, provides reimbursement benefits until the participant attains age 65. The program also covers dependents of retirees, in addition to former employees. Contributions are required. Retirees may choose one of two self-insured indemnity plan options. Effective February 1, 1999, the CHRISTUS Health postretirement benefit plan was curtailed prospectively. As of the effective date, new employees or employees that had not vested as of that date are not eligible for the postretirement health care benefits. The liability associated with the postretirement plan will be reduced as employee participation decreases.

Simplified Early Retirement Plan (SERP)- Prior to the formation of CHRISTUS, a plan for executives was curtailed prospectively. Under this plan, eligible participants receive a cash benefit payment until death and participate in the System's retiree health, dental and group-term life program. Fewer than two dozen participating retirees currently maintain benefit payment status. Benefits are recalculated when participants attain age 65 and remain constant thereafter. At June 30, 2008 and 2007, the total liability recorded pertaining to this SERP plan was \$5,351,000 and \$5,378,000, respectively.

Restoration Plan- The restoration plan, a nonqualified deferred compensation plan, was designed to restore benefits that are lost under the cash balance plan due to the statutory limit on recognizable compensation. Eligibility is limited to designated executives. The plan provides benefits upon termination of employment to qualifying participants. Plan benefits are calculated using the same methodology for the cash balance plan; vesting requirements are also the same. The restoration plan is unfunded.

10. CASH BALANCE PLAN AND POSTRETIREMENT HEALTH CARE BENEFITS (Continued)

The measurement date for all plans is June 30. Components of net periodic benefit cost, recorded as a component of employee compensation and benefits, for the years ended June 30, 2008 and 2007, consisted of the following (in thousands):

	Cash Balance Plan		Postretirement		SERP		Restoration Plan	
	2008	2007	2008	2007	2008	2007	2008	2007
Service cost	$ 40,353	$ 40,841	$ 958	$ 1,048	$ -	$ -	$ 278	$ 275
Interest cost	40,252	38,348	1,145	1,221	-	-	227	181
Expected return on assets	(47,860)	(39,268)	-		-	-	-	-
Amortization of prior service cost	(850)	(850)	-		-	-	103	103
Recognized net actuarial loss (gain)	1,280	9,439	-	-	(27)	(184)	211	112
Net benefit cost	$ 33,175	$ 48,510	$ 2,103	$ 2,269	$ (27)	$ (184)	$ 819	$ 671

Effective June 30, 2007, the System adopted the recognition provisions of FASB Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans— an amendment of FASB Statements No. 87, 88, 106, and 132(R)*. This Statement requires employers to recognize in their balance sheets the overfunded or underfunded status of defined benefit plans, measured as the difference between the fair value of plan assets and the projected benefit obligation. Employers must recognize the change in the funded status of the plan in the year in which the change occurs through unrestricted net assets. Prior to the adoption of the recognition provisions of Statement No. 158, the System accounted for its cash balance plan, postretirement plan, SERP, and restoration plan under Statement No. 87, *Employees' Accounting for Pensions*. Statement No. 87 required that a liability (minimum pension liability) be recorded when the accumulated benefit obligation (ABO) liability exceeded the fair value of plan assets. At June 30, 2008 and 2007, unrestricted net assets include $114,587,000 and $76,745,000, respectively, of amounts arising from defined benefit plans that have not yet been recognized in net periodic benefit cost. Amounts recognized in unrestricted net assets expected to be recognized in net periodic benefit cost during fiscal 2009 are $5,279,000.

The adoption of Statement No. 158 had no effect on the System's revenue in excess of expenses, gains, and support for the year ended June 30, 2007, did not affect any financial covenants, and is not expected to materially affect the System's operating results in future periods.

10. CASH BALANCE PLAN AND POSTRETIREMENT HEALTH CARE BENEFITS (Continued)

The following table sets forth the changes in benefit obligations, changes in plan assets, and funded status of the plans measured as of June 30, respectively (in thousands):

	Cash Balance Plan		Postretirement		SERP		Restoration Plan	
	2008	2007	2008	2007	2008	2007	2008	2007
Changes in benefit obligation.								
Benefit obligations—beginning of year	$ 691,274	$ 657,719	$ 19,628	$ 20,903	$ 5,378	$ 5,562	$ 3,924	$ 3,098
Service cost	40,353	40,841	958	1,048	-	-	278	275
Interest cost	40,252	38,347	1,145	1,221	-	-	227	181
Actuarial (gain) loss	(32,411)	4,186	(547)	(2,790)	(27)	(184)	(311)	983
Benefits paid	(40,090)	(49,820)	(802)	(754)	-	-	(178)	(613)
Benefit obligation—end of year	$ 699,378	$ 691,273	$ 20,382	$ 19,628	$ 5,351	$ 5,378	$ 3,940	$ 3,924
Change in plan assets:								
Fair value of plan assets—beginning of year	$ 635,440	$ 518,370	$ -	$ -	$ -	$ -	$ -	$ -
Actual return on plan assets	(23,447)	95,930	-	-	-	-	-	-
Employer contributions	44,523	70,959	802	754	-	-	178	613
Benefits paid	(40,091)	(49,820)	(802)	(754)	-	-	(178)	(613)
Fair value of plan assets—end of year	$ 616,425	$ 635,439	$ -	$ -	$ -	$ -	$ -	$ -
Funded status of the plans:								
Under funded	$ (82,953)	$ (55,834)	$ (20,382)	$ (19,628)	$ (5,351)	$ (5,378)	$ (3,940)	$ (3,924)
Unrecognized net actuarial loss (gain)	116,982	79,366	(1,000)	(3,057)	-	-	1,555	2,077
Unrecognized prior service cost	(4,721)	(5,571)	-	-	-	-	771	874
Accrued benefit cost	$ 29,308	$ 17,961	$ (21,382)	$ (22,685)	$ (5,351)	$ (5,378)	$ (1,614)	$ (973)

10. CASH BALANCE PLAN AND POSTRETIREMENT HEALTH CARE BENEFITS (Continued)

As of June 30, 2008 and 2007, the CHRISTUS cash balance plan, only, had accumulated benefit obligations of $649,667,000 and $629,050,000, respectively. Assumptions used to determine benefit obligations and net periodic benefit cost for the fiscal years were as follows:

	Cash Balance Plan		Postretirement		SERP		Restoration Plan	
	2008	2007	2008	2007	2008	2007	2008	2007
Benefit obligations:								
Discount rate	6.23 %	6.00 %	6.50 %	6.00 %	6.23 %	6.00 %	6.23 %	6.00 %
Rate of compensation increase	5.74	5 74	N/A	N/A	5.74	5.74	5.74	5.74
Net periodic benefit cost:								
Discount rate	6.00	6.00	6.50	6 00	6 00	6.00	6.00	6.00
Expected long-term return on plan assets	7.50	7.50	N/A	N/A	N/A	N/A	N/A	N/A
Rate of compensation increase	5.74	5.74	N/A	N/A	5.74	5.74	5.74	5.74

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

The following information pertains only to the CHRISTUS Health postretirement plan. The first chart details information pertaining to assumed health care cost trend rates. The second chart depicts the effect of a one-percentage-point change in assumed health care cost trend rates:

	Postretirement	
	2008	2007
Assumed health care cost trend rates at June 30	9.0%	10.0%
Health care cost trend rate assumed for next year	8.0	9.0
Ratio to which the cost trend rate is assumed to decline (the ultimate trend rate)	5.0	5.0
Year that the rate reaches the ultimate trend rate	2013	2013

	Postretirement 1% Point Increase	Postretirement 1% Point Decrease
	(in thousands)	
Effect on total of service cost and interest cost components	$ 200	$ (177)
Effect on postretirement benefit obligation	1,753	(1,567)

10. CASH BALANCE PLAN AND POSTRETIREMENT HEALTH CARE BENEFITS (Continued)

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

The asset allocations for the cash balance plan at June 30, 2008 and 2007, by asset category are detailed below. The postretirement plan, SERP, and restoration plan are unfunded.

	2008	2007
Asset category:		
Cash and cash equivalents	$ 49,314	$ 25,418
Equity investments in managed funds (as discussed in Note 5)	240,406	279,593
Fixed income securities	80,135	82,607
Equity securities	246,570	247,821
Total	$ 616,425	$ 635,439

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

	2008	2007
Allocation of plan assets by asset category:		
Cash and cash equivalents	8.0 %	4.0 %
Equity investments in managed funds (as discussed in Note 5)	39.0	44.0
Fixed income securities	13.0	13.0
Equity securities	40.0	39.0
Total	100.0 %	100.0 %

10. CASH BALANCE PLAN AND POSTRETIREMENT HEALTH CARE BENEFITS (Continued)

Contributions- In fiscal year 2009, CHRISTUS expects to contribute $45,000,000 to the cash balance plan based on asset values for the plan year beginning January 1, 2008. Contributions to the cash balance plan of $44,523,000 and $70,959,000 have been made for plan years beginning January 1, 2007 and 2006, respectively. Since the postretirement plan, SERP, and restoration plan are unfunded, no cash contributions are expected.

Benefit Payments- The following benefit payments, which reflect expected future service relative to the cash balance plan and expected benefit payments for services previously rendered relative to the postretirement plan and the SERP, are expected to be paid as follows (in thousands):

	Cash Balance Plan	Post-Retirement	SERP	Restoration Plan
2009	$ 39,584	$ 1,124	$ 597	$ 287
2010	42,886	1,245	573	302
2011	45,505	1,442	547	520
2012	47,730	1,549	520	296
2013	49,741	1,715	492	314
Years 2014–2018	285,799	11,413	2,040	1,994

Defined Contribution Plans- The System has a defined-contribution plan (Matched Savings Plan) covering substantially all CHRISTUS Health employees. Annual employee contributions are limited to 50% of compensation up to the IRS dollar limits. The System will match 50% of employee contributions, not to exceed 4% of annual compensation. Employer contributions vest to the employee over a five-year period. For the years ended June 30, 2008 and 2007, expenses attributable to the Matched Savings Plan amounted to $7,998,576 and $7,709,009, respectively.

CHRISTUS St. Vincent Regional Medical Center (St. Vincent) has two 403(b) defined contribution plans for union and nonunion employees. St. Vincent makes a set lump-sum contribution per year for nurse union employees and a contribution of 3.5% of gross salaries for nonunion employees as defined by the plans' agreements. For the period since the close of the transaction, St. Vincent has incurred approximately $604,000 in expenses related to the plans.

ExecuFLEX Benefit Plan

The System established an ExecuFLEX plan (ExecuFLEX), which is limited to designated executives. Plan participants receive an ExecuFLEX allowance to be allocated among four different components: CHRISTUS Health ExecuFLEX Individual Long-Term Disability Plan,

10. CASH BALANCE PLAN AND POSTRETIREMENT HEALTH CARE BENEFITS (Continued)

CHRISTUS Health ExecuFLEX Supplemental Survivor Plan, CHRISTUS Health ExecuFLEX Spouse Survivor Plan, and CHRISTUS Health ExecuFLEX Deferred Income Account (DIA) Plan.

CHRISTUS Health maintains a collateral interest in the individual life insurance policies under the supplemental survivor plan and the spouse survivor plan to the extent of the cumulative advanced premiums paid on behalf of the participant(s). Upon termination of employment, a participant is required to surrender any policy with a cash surrender value less than the advanced premiums.

The DIA Plan is a nonqualified deferred compensation plan; eligibility is limited to designated executives. Benefits vest based on certain qualifying events and are paid to participants when fully vested. The funds contributed by participants to this component of the ExecuFLEX Plan are held in a Rabbi Trust until vesting requirements have been satisfied. The System has an asset recorded for the investments in the Rabbi Trust with a corresponding liability. As of June 30, 2008 and 2007, the total asset and the corresponding liability were $6,872,000 and $7,566,000, respectively.

11. SELF-FUNDED LIABILITIES

The System self-funds and insures for primary professional and general liability, workers' compensation, and employee medical benefits. A wholly owned, captive insurance company is used to fund primary professional and general liability. Additionally, the System internally sets aside funds for workers' compensation and employee medical benefits. Funding amounts are based on actuarial recommendations.

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

Emerald Assurance Cayman, Ltd. (Emerald), a wholly owned subsidiary of CHRISTUS Health, was incorporated in the Cayman Islands on June 27, 2003, and operates subject to the provisions of the Companies Law (2003 Revision) of the Cayman Islands. Emerald was granted an Unrestricted Class "B" Insurer's license on June 30, 2003, which it holds subject to the provisions of the Insurance Law (2003 Revision) of the Cayman Islands. Emerald has received an undertaking from the Cayman Islands government exempting it from local income, profits, and capital gains taxes until July 29, 2023. No such taxes are currently levied in the Cayman Islands.

12. CONCENTRATIONS OF CREDIT RISK

The System grants credit without collateral to its patients, most of whom are local residents of the geographies of the various System health care centers and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors at June 30, 2008 and 2007, was as follows:

Medicare	27.7 %	29.6 %
Medicaid	11.6	14.9
Managed care organizations	30.9	29.0
Commercial insurance	4.9	3.4
Self pay	12.0	11.8
Others	12.9	11.3
	100.0 %	100.0 %

13. COMMITMENTS AND CONTINGENCIES

Operating Leases

The System leases various equipment and facilities under noncancelable operating leases expiring at various dates through May 19, 2045. Total rental expense in 2008 and 2007 for all operating leases was approximately $29,852,000 and $20,041,000, respectively.

The following is a schedule by year of future minimum lease payments under operating leases as of June 30, 2008, that have initial or remaining lease terms in excess of one year (in thousands):

Year Ending June 30	
2009	$ 20,050
2010	16,130
2011	14,601
2012	12,913
2013	11,785
Thereafter	35,325
Total	$ 110,804

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

14. FUNCTIONAL EXPENSES

The System provides general health care services to residents throughout various geographic locations. Expenses related to providing these services at June 30, 2008 and 2007, are as follows (in thousands):

	2008	2007
Health care services	$2,296,947	$2,238,968
Physician services	100,323	37,566
General and administrative	779,410	509,737
Total	$3,176,680	$2,786,271

15. FAIR VALUE OF FINANCIAL INSTRUMENTS

At June 30, 2008 and 2007, the System's financial instruments included cash and cash equivalents, accounts receivable, assets limited as to use, accounts payable and accrued expenses, estimated third-party payor settlements, and long-term debt. The carrying amounts reported in the consolidated balance sheets for these financial instruments except for long-term debt approximate their fair value. The fair value of the System's long-term debt, based on quoted market prices, at June 30, 2008 and 2007, was approximately $1,272,821,000 and $939,245,000, respectively, as compared with its carrying value of $1,266,222,000 and $937,962,000, respectively.

16. TEMPORARILY AND PERMANENTLY RESTRICTED NET ASSETS

Temporarily restricted net assets at June 30, 2008 and 2007, are available for the following purposes or periods:

	2008	2007
Health care services:		
Purchase of equipment/capital improvement	$ 23,094	$ 12,879
Indigent care	2,426	1,873
Health education	2,042	2,137
Health care services	9,279	10,606
Community Outreach	11,767	12,527
Other	4,331	5,462
Total	$ 52,939	$ 45,484

16. TEMPORARILY AND PERMANENTLY RESTRICTED NET ASSETS (Continued)

Permanently restricted net assets at June 30, 2008 and 2007, are restricted as follows (in thousands):

	2008	2007
Investments to be held in perpetuity, the income from which is expendable to support health care services (reported as operating income)	$ 7,214	$ 7,149
Endowment requiring income to be added to original gift	3,347	5,550
Other	2,556	1,908
Total	$ 13,117	$ 14,607

17. ASSETS HELD FOR SALE AND DISCOUNTINUED OPERATIONS

In accordance with SFAS No. 144, *Accounting for Impairment or Disposal of Long-Lived Assets*, the System classified certain long-lived assets as "held for sale" in fiscal year 2008. At June 30, 2007, a total of $5,509,000 in assets related to the Bossier facility in the CHRISUTS Health Northern Louisiana Region were classified as held for sale. These assets were not sold during fiscal year 2008 and were reclassified as held and used. At June 30, 2008, management is negotiating an agreement for the lease of the Bossier facility.

At June 30, 2006, CHRISTUS St. Joseph's Hospital located in Houston, Texas, which was part of the CHRISTUS Health Gulf Coast Region had entered into an asset purchase agreement with Hospital Partners of America, Inc. The sale of the Hospital was transacted August 19, 2006. All net income from operations for the Hospital of $7,816,000 has been accounted for as discontinued operations for the year ended June 30, 2007.

The System classified net property, plant, and equipment of $2,021,000 as held for sale at June 30, 2008, related to a medical office building in the CHRISTUS Ark-La-Tex Region.

18. PURCHASE OF FACILITIES

On February 1, 2008, the System acquired McKenna Memorial Hospital, a 132-bed general acute care hospital in New Braunfels, Texas, and McKenna Medical Group, as well as the investments in the McKenna Ambulatory Surgery Center (MASC) and McKenna Equipment Leasing Company (MELC), and other operations such as Home Care in accordance with the terms of the Asset Purchase Agreement for a cash consideration of $73,443,000. Subsequent to the transaction, the hospital name was changed to CHRISTUS Santa Rosa New Braunfels (New Braunfels). Contingent on the completion of the sale, CHRISTUS Health agreed to provide the McKenna Legacy Foundation, a Texas nonprofit corporation, a $14,000,000 grant payable over seven years of which $2,000,000 was paid at the time of purchase. The total purchase price, including the contribution by CHRISTUS Health is $85,443,000. The results of operations for the acquired entities for the five months since the date of the transaction have been included in

18. PURCHASE OF FACILITIES (Continued)

consolidated statement of operations and changes in net assets of the System. The transaction was accounted for using the purchase method of accounting. The aggregate purchase price was allocated to assets acquired and liabilities assumed based upon preliminary information and are subject to change when additional information concerning final asset and liability valuations is obtained. The resulting goodwill of $37,700,000 will be amortized over a period of 25 years from the date of the transaction.

On April 9, 2008, the System entered into a contribution agreement with St. Vincent Hospital (SVH) and SVH SupportCo (SupportCo) to become a 50% member of St. Vincent Regional Medical Center (SVRMC) in Santa Fe, New Mexico. Subsequent to the transaction, the entity name was changed to CHRISTUS St. Vincent Regional Medical Center, which consists of a general acute care hospital licensed for 180 beds, a physician group practice, and interest in an imaging center. Per the contribution agreement, CHRISTUS Health agreed to pay $74,250,000 to SupportCo in exchange for its membership interest. At the close of the transaction, CHRISTUS Health paid cash of $57,250,000 to SupportCo and withheld the remaining $17,000,000 pending resolution of certain outstanding issues over the next five years. CHRISTUS provides certain management and other services to SVRMC including the employment of senior management. CHRISTUS exercises full operating authority over the facility. The transaction was accounted for as a business combination under relevant accounting guidance and the financial results of the joint venture since the date of the transaction have been consolidated in the financial results of the System with a 50% minority interest reflected at June 30, 2008. The aggregate purchase price was allocated to assets acquired and liabilities assumed based upon preliminary information and are subject to change when additional information concerning final asset and liability valuations is obtained. The resulting goodwill of $22,606,000 will be amortized over a period of 25 years from the date of the transaction.

19. SUBSEQUENT EVENT

On September 13, 2008 CHRISTUS St. John in the CHRISTUS Health Gulf Coast region, CHRISTUS Hospital – St. Mary in the CHRISTUS Health Southeast Texas Region and other non-hospital facilities in the CHRISTUS System sustained damage from Hurricane Ike resulting in property damage and business interruption. The System is currently in the process of estimating total damages. CHRISTUS Health maintains property and business interruption insurance through commercial independent property and casualty insurance companies. Additionally, CHRISTUS Health self-insures property and casualty losses through the wholly-owned captive insurance company, Emerald Assurance.

Other Financial Information

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Independent Auditors' Report on Other Financial Information

To the Board of Directors of CHRISTUS Health

We have audited, in accordance with auditing standards generally accepted in the United States, the consolidated financial statements of CHRISTUS Health as of June 30, 2008, and for the year then ended, and have issued our unqualified opinion thereon dated September 11, 2008. The accompanying consolidating information is not intended to present the financial position, results of operations, and cash flows of the individual companies, as would complete financial statements including necessary disclosures, and should be read in conjunction with the consolidated financial statements and our report thereon. The scope of our auditing procedures was not designed to provide a basis for expressing opinions on the presentations of the accounts of the individual companies on a stand-alone basis and, accordingly, we do not express such opinions. The accompanying community benefit information is presented for purposes of additional analysis and is not a required part of the basic financial statements taken as a whole. Such information, except for that portion marked "unaudited," on which we express no opinion, has been subjected to the auditing procedures applied in our audit of the consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

Ernst + Young LLP

September 11, 2008

COMMUNITY BENEFIT (UNAUDITED)

CHRISTUS complies with the State of Texas requirements for reporting and adheres to the Catholic Health Association's (CHA), *A Guide for Planning and Reporting Community Benefits,* Copyright 2006.

Following is a summary of the System's quantifiable costs of community benefits provided for the years ended June 30, 2008 and 2007 (in thousands):

	2008	2007
	UNAUDITED	
Programs and services for the poor and underserved:		
Charity care at unpaid cost	$ 101,589	$ 141,297
Unpaid cost of Medicaid and other public programs	93,216	61,403
Community services for the poor and underserved	27,215	17,837
Total for the poor and the underserved	222,020	220,537
Community services for the broader community:		
Education and research	10,158	16,038
Other community services	6,453	11,271
Total for the broader community	16,611	27,309
Total community benefits	$ 238,631	$ 247,846

This amount is calculated following CHA guidelines. There are multiple reporting requirements to various organizations of charity care and community benefit. The reported benefit varies based on the definitional and timing requirements of the requesting organization.

In addition to the Community Benefits reported above, the State of Texas requires that the unpaid costs of Medicare and Other Government Sponsored Programs be reported. For the fiscal years ended 2008 and 2007, the unpaid costs of these programs were $249,999,000 and $228,311,000, respectively. The unpaid costs of the Medicare program represent the cost of providing services to primarily elderly beneficiaries of the Medicare program, in excess of governmental and managed care contract payments. The unpaid costs of Other Government Sponsored Programs represent the cost for providing health care services to the beneficiaries of the Department of Defense (DOD) civilian care, included as per the State of Texas guidelines.

As noted the CHRISTUS Community Direct Investment Program (CDI) was established to support community-driven initiatives primarily for affordable housing and economic development by providing financing at below market interest rates. At June 30, 2008 and 2007, the CDI program had $10,634,000 and $8,700,000, respectively, in outstanding loans; approximately 83% and 97%, respectively, of these loans relate to projects in CHRISTUS Health regions. The difference between the interest rates charged on the loans and the amount that the System would have earned on these monies is the foregone interest that is considered a community benefit. In fiscal year 2008 and 2007, the amount recognized as a community benefit related to this program was $288,029 and $236,000, respectively.

As noted the CHRISTUS Fund was established for the purpose of providing grants to support community planning, healthy community initiatives, and community-based programs with a focus on the poor and underserved areas where CHRISTUS Health ministries and sponsoring congregations are involved. During fiscal years 2008 and 2007, the CHRISTUS Fund provided grants of $2,795,599 and $3,974,000, respectively; approximately 95% of the grants relate to programs in CHRISTUS regions.

CHRISTUS HEALTH
COMBINING BALANCE SHEET
COMBINED GROUP AND NON-COMBINED GROUP
AS OF JUNE 30, 2008
(in thousands)

	CHRISTUS System Total	CHRISTUS Combined Group Total	CHRISTUS Non-Combined Group Total
ASSETS			
CURRENT ASSETS			
Cash & cash equivalents	$ 174,474	$ 66,600	$ 107,874
Short-term investments	277,738	248,045	29,693
Equity in managed funds	315,262	315,262	0
Assets whose use is limited, required for current liabilities	55,245	15,384	39,861
Patient accounts receivable–net of allowance for uncollectible accounts	375,705	311,721	63,984
Estimated third-party payor settlements	2,371	3,157	(786)
Notes and other receivables	154,503	140,992	13,511
Inventories	83,017	73,521	9,496
Assets held for sale	2,021	2,021	0
Security pledge to creditors	36,502	36,502	0
Security lending collateral	39,789	39,789	0
Other current assets	31,291	27,881	3,410
TOTAL CURRENT ASSETS	1,547,918	1,280,875	267,043
ASSETS WHOSE USE IS LIMITED OR RESTRICTED-Less current portion	690,719	496,449	194,270
PROPERTY, PLANT, AND EQUIPMENT-Net of accumulated depreciation	1,921,396	1,691,602	229,794
OTHER ASSETS			
Investment in Unconsolidated Subsidiaries	181,337	167,325	14,012
Derivative investments	2,941	2,941	0
Goodwill, net	119,387	112,953	6,434
Other assets	86,315	180,875	(94,560)
Other restricted net assets	27,366	10,373	16,993
TOTAL OTHER ASSETS	417,346	474,467	(57,121)
TOTAL ASSETS	$ 4,577,379	$ 3,943,393	$ 633,986

CHRISTUS HEALTH
COMBINING BALANCE SHEET
COMBINED GROUP AND NON-COMBINED GROUP
AS OF JUNE 30, 2008
(in thousands)

	CHRISTUS System Total	CHRISTUS Combined Group Total	CHRISTUS Non-Combined Group Total
LIABILITIES AND NET ASSETS			
CURRENT LIABILITIES			
Accounts payable and accrued expenses	$ 373,241	$ 197,580	$ 175,661
Accrued employee compensation & benefits	140,987	118,937	22,050
Accrued benefits current portion	3,551	279	3,272
Estimated third-party payor settlements	14,332	8,182	6,150
Current portion of long-term debt	30,306	19,499	10,807
Payable under security lending agreement	39,789	39,789	0
Long term obligations subject to remarketing agreements	138,535	138,535	0
TOTAL CURRENT LIABILITIES	740,741	522,801	217,940
LONG-TERM DEBT, less current portion	1,097,381	1,054,715	42,666
ACCRUED PENSION BENEFITS, less current portion	86,614	86,614	0
OTHER LONG-TERM OBLIGATIONS - Primarily related to self-funded liabilities - less current portion	136,027	90,194	45,833
TOTAL LIABILITIES	2,060,763	1,754,324	306,439
MINORITY INTEREST	78,021	1,073	76,948
NET ASSETS:			
Unrestricted	2,372,539	2,172,278	200,261
Temporarily Restricted	52,939	11,041	41,898
Permanently Restricted	13,117	4,677	8,440
TOTAL NET ASSETS	2,438,595	2,187,996	250,599
TOTAL LIABILITIES & NET ASSETS	$ 4,577,379	$ 3,943,393	$ 633,986

CHRISTUS HEALTH
COMBINING STATEMENT OF OPERATIONS
COMBINED GROUP AND NON-COMBINED GROUP
FOR THE YEAR ENDED JUNE 30, 2008
(In thousands)

	CHRISTUS System Total	CHRISTUS Combined Group Total	CHRISTUS Non-Combined Group Total
UNRESTRICTED REVENUES, GAINS, AND OTHER SUPPORT:			
Net patient service revenue	$ 2,806,809	$ 2,474,919	$ 331,890
Premium revenue	147,874	147,567	307
Other revenue	186,468	116,049	70,419
Equity in unconsolidated subsidiearies	26,312	23,356	2,956
TOTAL OPERATING REVENUE	3,167,463	2,761,891	405,572
EXPENSES:			
Employee compensation and benefits	1,398,001	1,180,584	217,417
Services and other	818,168	702,283	115,885
Supplies	516,996	484,143	32,853
Depreciation and amortization	216,846	201,391	15,455
Provision for uncollectible accounts	174,069	163,142	10,927
Interest	52,600	49,699	2,901
TOTAL EXPENSES	3,176,680	2,781,242	395,438
OPERATING (LOSS) INCOME	(9,217)	(19,351)	10,134
NONOPERATING INVESTMENT (LOSS) INCOME	(98,476)	(99,699)	1,223
NONOPERATING (LOSS) INCOME	(1,155)	(4,958)	3,803
REVENUES IN (DEFICIT) EXCESS OF EXPENSES	$ (108,848)	$ (124,008)	$ 15,160

Reports on Federal and State Award Programs

CHRISTUS Health
Year Ended June 30, 2008

0808-0976993-RFAP

CHRISTUS Health

Reports on Federal and State Award Programs

Year Ended June 30, 2008

Contents

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

The Board of Directors
CHRISTUS Health

We have audited the consolidated financial statements of CHRISTUS Health as of and for the year ended June 30, 2008, and have issued our report thereon dated September 10, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered CHRISTUS Health's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of CHRISTUS Health's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of CHRISTUS Health's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Ernst & Young

Compliance and Other Matters

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

* * * * *

This report is intended solely for the information and use of management, the Board of Directors, others within the entity, federal and state awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Ernst + Young LLP

September 11, 2008

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Report on Compliance With Requirements Applicable to Each Major Program and on Internal Control Over Compliance in Accordance With OMB Circular A-133 and State of Texas Uniform Grant and Contract Management Standards Act of 1981, and on Schedule of Expenditures of Federal and State Awards

The Board of Directors
CHRISTUS Health

Compliance

We have audited the compliance of CHRISTUS Health with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs and the types of compliance requirements described in the State of Texas Uniform Grant and Contract Management Standards Act of 1981 (UGCMS) that are applicable to each of its major state programs for the year ended June 30, 2008. CHRISTUS Health's major federal and state programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal and state programs is the responsibility of CHRISTUS Health's management. Our responsibility is to express an opinion on CHRISTUS Health's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*; and UGCMS. Those standards, OMB Circular A-133 and the UGCMS, require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal and state program occurred. An audit includes examining, on a test basis, evidence about CHRISTUS Health's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of CHRISTUS Health's compliance with those requirements.

As described in item 08-2 in the accompanying schedule of findings and questioned costs, CHRISTUS Health did not comply with federal requirements regarding procurement and suspension and debarment that are applicable to its National Bioterrorism Hospital Preparedness

Program. As described in item 08-4 in the accompanying schedule of findings and questioned costs, CHRISTUS Health did not comply with state requirements regarding subrecipient monitoring that are applicable to its Family Practice Residency Program. Compliance with such requirements is necessary, in our opinion, for CHRISTUS Health to comply with requirements applicable to those programs.

In our opinion, except for the noncompliance described in the preceding paragraph, CHRISTUS Health complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal and state programs for the year ended June 30, 2008. The results of our auditing procedures also disclosed other instances of noncompliance that are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items 08-1 and 08-3.

Internal Control Over Compliance

The management of CHRISTUS Health is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal and state programs. In planning and performing our audit, we considered CHRISTUS Health's internal control over compliance with requirements that could have a direct and material effect on a major federal or state program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of CHRISTUS Health's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in the entity's internal control that might be significant deficiencies or material weaknesses as defined below. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be significant deficiencies.

A *control deficiency* in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal or state program on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal or state program such that there is a more than remote likelihood that noncompliance with a type of compliance requirement of a federal or state program that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as items 08-1, 08-2, 08-3, and 08-4 to be significant deficiencies.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal or state program will not be prevented or detected by the entity's internal control. We consider the deficiencies in internal control over compliance described in the accompany schedule of findings and questioned costs as item 08-1, 08-2, and 08-4 to be material weaknesses.

CHRISTUS Health's response to the findings identified in our audit is described in the accompanying schedule of findings and questioned costs. We did not audit CHRISTUS Health's response and, accordingly, we express no opinion on it.

Schedule of Expenditures of Federal and State Awards

We have audited the consolidated financial statements of CHRISTUS Health as of and for the year ended June 30, 2008, and have issued our report thereon dated September 10, 2008. Our audit was performed for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The accompanying schedule of expenditures of federal and state awards is presented for purposes of additional analysis as required by OMB Circular A-133, the Louisiana Hospital Association Policy Number 3105-96 and the UGCMS and is not a required part of the consolidated financial statements. Such information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the consolidated financial statements taken as a whole.

* * * * *

This report is intended solely for the information and use of management, the Board of Directors, others within the entity, federal and state awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Ernst + Young LLP

September 11, 2008

CHRISTUS Health

Schedule of Expenditures of Federal and State Awards

Year Ended June 30, 2008

Federal Grantor/State Grantor/Pass-Through Grantor/Program or Cluster Title	Location	Federal CFDA Number/ State Contract Number	Pass-Through Entity Identifying Number	Expenditures
FEDERAL AWARDS				
U.S. Department of Agriculture:				
Indirect Awards:				
Pass-through the Texas Department of State Health Services:			32-0113643	
Special Supplemental Nutrition Program for Women, Infants, and Children	CHRISTUS Santa Rosa Health Care	10.557		$ 667,073
Total U.S. Department of Agriculture				667,073
U.S. Department of Health and Human Services – National Bioterrorism Hospital Preparedness Program:				
Indirect Awards:				
Pass-through Louisiana Hospital Association:			72-0489377	
National Bioterrorism Hospital Preparedness Program	Dubuis Health System	93.889		3,445
Pass-through the East Texas Gulf Coast Regional Trauma Advisory Council – Area R:			72-0620280	
National Bioterrorism Hospital Preparedness Program	Dubuis Health System	93.889		74,550
Pass-through the Northeast Texas Regional Advisory Council – Trauma Service Area F:			72-2553157	
National Bioterrorism Hospital Preparedness Program	Dubuis Health System	93.889		620
Pass-through the Southeast Texas Trauma Regional Advisory Council – Area Q:			76-0419172	
National Bioterrorism Hospital Preparedness Program	Dubuis Health System	93.889		1,577
Pass-through the Coastal Bend Regional Advisory Council – Area U:			74-2681638	
National Bioterrorism Hospital Preparedness Program	Dubuis Health System	93.889		11,988
Total Dubuis Health System – National Bioterrorism Hospital Preparedness Program				92,180

CHRISTUS Health

Schedule of Expenditures of Federal and State Awards (continued)

Federal Grantor/State Grantor/Pass-Through Grantor/Program or Cluster Title	Location	Federal CFDA Number/ State Contract Number	Pass-Through Entity Identifying Number	Expenditures
FEDERAL AWARDS (continued)				
Pass-through the Northeast Texas Trauma Regional Advisory Council – Trauma Service Area F:			75-2553157	
National Bioterrorism Hospital Preparedness Program	CHRISTUS Health Ark-La-Tex	93.889		$ 3,733
Pass-through Texas Department of State Health Services:			32-0113643	
National Bioterrorism Hospital Preparedness Program	CHRISTUS Health Ark-La-Tex	93.889		1,250
Total CHRISTUS Health Ark-La-Tex – National Bioterrorism Hospital Preparedness Program				4,983
Pass-through the East Texas Gulf Coast Regional Trauma Advisory Council – Trauma Service Area R:			72-0620280	
National Bioterrorism Hospital Preparedness Program	CHRISTUS Health Southeast Texas	93.889		464,181
Pass-through Texas Department of State Health Services:			32-0113643	
National Bioterrorism Hospital Preparedness Program	CHRISTUS Health Southeast Texas	93.889		1,250
Total CHRISTUS Health Southeast Texas – National Bioterrorism Hospital Preparedness Program				465,431
Pass-through the Southeast Texas Trauma Regional Advisory Council – Area Q:			76-0419172	
National Bioterrorism Hospital Preparedness Program	CHRISTUS Health Gulf Coast	93.889		27,162
Pass-through the Louisiana Hospital Association:			72-0489377	
National Bioterrorism Hospital Preparedness Program	CHRISTUS Health Central Louisiana	93.889		79,010
National Bioterrorism Hospital Preparedness Program	CHRISTUS Health Southwestern Louisiana	93.889		28,022
National Bioterrorism Hospital Preparedness Program	CHRISTUS Health Northern Louisiana	93.889		89,236

CHRISTUS Health

Schedule of Expenditures of Federal and State Awards (continued)

Federal Grantor/State Grantor/Pass-Through Grantor/Program or Cluster Title	Location	Federal CFDA Number/ State Contract Number	Pass-Through Entity Identifying Number	Expenditures
FEDERAL AWARDS (continued)				
Pass-through the Coastal Bend Regional Advisory Council – Area U:			74-2681638	
National Bioterrorism Hospital Preparedness Program	CHRISTUS Health – Spohn	93.889		$ 113,950
Pass-through Texas Department of State Health Services:			32-0113643	
National Bioterrorism Hospital Preparedness Program	CHRISTUS Spohn Health System	93.889		3,750
Total CHRISTUS Spohn Health System – National Bioterrorism Hospital Preparedness Program				117,700
Pass-through the Southwest Texas Regional Advisory Council:			74-2896432	
National Bioterrorism Hospital Preparedness Program	CHRISTUS Santa Rosa Health Care	93.889		48,650
Total National Bioterrorism Hospital Preparedness Program				952,374
Pass-through the Louisiana Department of Health & Hospitals:			72-6011595	
Small Rural Hospital Improvement Grant Program (SHIP)	CHRISTUS Health Central Louisiana	93.301		13,147
Pass-through Louisiana Dept of Health & Hospitals:	CHRISTUS Health Central Louisiana		72-6011595	
State Rural Hospital Flexibility Program		93.241		1,000
Pass-through the Biomedical Research Foundation of Northwest Louisiana:			51-1711612	
Cooperative Agreements to Improve the Health Status of Minority Populations	CHRISTUS Health Central Louisiana	93.004		122,354

Schedule of Expenditures of Federal and State Awards (continued)

Federal Grantor/State Grantor/Pass-Through Grantor/Program or Cluster Title	Location	Federal CFDA Number/ State Contract Number	Pass-Through Entity Identifying Number	Expenditures
FEDERAL AWARDS (continued)				
Pass-through Harris County:			76-0454514	
HIV Emergency Relief Project Grants	CHRISTUS HomeCare	93.914		$ 85,060
Pass-through the Houston Regional HIV/AIDS Resource Group, Inc.:			76-0414232	
HIV Care Formula Grants	CHRISTUS HomeCare	93.917		3,600
Pass-through Texas Department of State Health Services:			32-0113643	
Centers for Disease Control and Prevention Investigations and Technical Assistance	CHRISTUS Health Ark-La-Tex	93.283		2,500
Centers for Disease Control and Prevention Investigations and Technical Assistance	CHRISTUS Health Southeast Texas	93.283		2,500
Centers for Disease Control and Prevention Investigations and Technical Assistance	CHRISTUS Spohn Health System	93.283		7,500
Total Centers for Disease Control and Prevention Investigations and Technical Assistance				12,500
Total U.S. Department of Health & Human Services				1,190,035
TOTAL EXPENDITURES OF FEDERAL AWARDS				1,857,108
STATE AWARDS				
Louisiana				
State of Louisiana Department of Health and Hospitals:	CHRISTUS Health Central Louisiana			
Children's Health Insurance Program (CHIP)		Contract # 049698 CFMS # 655333		100,000
Injury Prevention		Contract # 048675 CFMS # 652179		61,634
Pollock School-Based Health Center		Contract # 048795 CFMS # 650588		48,973

CHRISTUS Health

Schedule of Expenditures of Federal and State Awards (continued)

Federal Grantor/State Grantor/Pass-Through Grantor/Program or Cluster Title	Location	Federal CFDA Number/ State Contract Number	Pass-Through Entity Identifying Number	Expenditures
STATE AWARDS (continued)				
Northwood School-Based Health Center		Contract # 048798 CFMS # 650592		$ 129,787
Grant School-Based Health Center Dry Prong Jr. High School		Contract # 048803 CFMS # 650569		127,553
Tioga Jr. High School-Based Health Center		Contract # 048825 CFMS # 650586		129,943
Glenmora School-Based Health Center		Contract # 048801 CFMS # 650630		143,045
Natchitoches High School-Based Health Center Lakeview Jr/Sr High School		Contract # 048817 CFMS # 650572		134,971
Buckeye School-Based Health Center		Contract # 048800 CFMS # 650551		146,674
Natchitoches Central School-Based Health Center		Contract # 049898 CFMS # 658148		111,147
Tioga Sr. High School-Based Health Center		Contract # 048822 CFMS # 650583		139,317
Leslie Moore & Pineville School-Based Health Center		Contract # 048819 CFMS # 650578		148,902
LaSalle School-Based Health Center Jena Jr/Sr High School		Contract # 048815 CFMS # 650571		148,639
Avoyelles School-Based Health Center Mansura Middle School		Contract # 048796 CFMS # 650590		147,912
Marthaville/Cloutierville School-Based Health Center		Contract # 049645 CFMS # 657156		68,500
Total CHRISTUS Health Central Louisiana				1,786,997

CHRISTUS Health

Schedule of Expenditures of Federal and State Awards (continued)

Federal Grantor/State Grantor/Pass-Through Grantor/Program or Cluster Title	Location	Federal CFDA Number/ State Contract Number	Pass-Through Entity Identifying Number	Expenditures
STATE AWARDS (continued)				
Louisiana Department of Health and Hospitals:	CHRISTUS Health Northern Louisiana			
Woodlawn Planning Grant Adolescent School Health Program		DHH# 049559 CFMS # 657157		$ 140,000
Adolescent School Health Program – CHRISTUS Schumpert Health System – Atkins Health Center		DHH# 048605 CFMS # 651369		139,419
Adolescent School Health Program – CHRISTUS Schumpert Health System – Linwood Health Center		DHH# 048606 CFMS # 651370		140,000
Children's Health Insurance Program (CHIP)		DHH# 049788 CFMS # 656065		40,797
Total CHRISTUS Health Northern Louisiana				460,216
Louisiana Department of Health and Hospitals:	CHRISTUS Health Southwestern Louisiana			
School-Based Clinics – Cameron Parish Schools		DHH# 048863 CFMS # 650610		146,678
School Based Health Clinic – Washington Marion High School		DHH# 048860 CFMS #650608		148,009
School Based Health Clinic – Clifton & Combre Fondel		DHH# 048858 CFMS # 650596		140,163
School Based Health Clinic – Molo Middle School		DHH# 048859 CFMS # 650605		120,645
Total CHRISTUS Health Southwestern Louisiana				555,495
Total expenditures of state awards – Louisiana				2,802,708

Schedule of Expenditures of Federal and State Awards (continued)

Federal Grantor/State Grantor/Pass-Through Grantor/Program or Cluster Title	Location	Federal CFDA Number/ State Contract Number	Pass-Through Entity Identifying Number	Expenditures
STATE AWARDS (continued)				
Texas				
Family Practice Residency Program				
Direct Awards (Texas Higher Education Coordinating Board):				
Family Practice Residency Program	CHRISTUS Santa Rosa Health Care	THECB Contract No. 157; 832		$ 225,000
Family Practice Residency Program Operational Grant	Christus Health Ark-La-Tex	THECB Contract No. 532; 651		130,659
Total Family Practice Residency Program – Direct Awards				355,659
Indirect Awards:				
Pass-thru from Nueces County Medical Education Foundation:				
Family Practice Residency Program Operational Grant	CHRISTUS Spohn Health System	17411098365024	74-1944150	444,290
Total Family Practice Residency Program – Indirect Awards				444,290
Total *Family* Practice Residency Program				799,949
Direct Awards (Texas Department of State Health Services):				
Texas Breast and Cervical Cancer Program	CHRISTUS Health Ark-La-Tex	2008-025372		6,854
Direct Awards (Office of Rural Community Affairs):				
Rural Health Facility Capital Improvement Loan Fund Program – Beeville	CHRISTUS Health Spohn	CILF-07006		50,000
Rural Health Facility Capital Improvement Loan Fund Program – Kleberg	CHRISTUS Health Spohn	CILF-07007		43,524
Rural Health Facility Capital Improvement Loan Fund Program – Alice	CHRISTUS Health Spohn	CILF-07005		45,059
Total Rural Health Facility Capital Improvement Loan Fund Program				138,583

CHRISTUS Health

Schedule of Expenditures of Federal and State Awards (continued)

Federal Grantor/State Grantor/Pass-Through Grantor/Program or Cluster Title	Location	Federal CFDA Number/ State Contract Number	Pass-Through Entity Identifying Number	Expenditures
STATE AWARDS (continued)				
Pass-through from the University of Texas Health Science Center at San Antonio:			74-1586031	
Graduate Medical Education Program	CHRISTUS Santa Rosa Health Care	N/A		$ 14,841
Total expenditures of state awards – Texas				960,227
TOTAL EXPENDITURES OF STATE AWARDS				3,762,935
TOTAL EXPENDITURES OF FEDERAL AND STATE AWARDS				$ 5,620,043

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

CHRISTUS Health

Notes to Schedule of Expenditures of Federal and State Awards

Year Ended June 30, 2008

1. Basis of Accounting

The schedule of expenditures of federal and state awards presents expenditures for all federal and state programs that were in effect during the year ended June 30, 2008.

Expenditures are reported on the accrual basis of accounting in accordance with generally accepted accounting principles. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations,* and *State of Texas Uniform Grant Management Standards.* Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the consolidated financial statements.

2. Nature of Activities

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

The amounts reported for the expenditures incurred for the year ended June 30, 2008, for the National Bioterrorism Hospital Preparedness Program (CFDA Number 93.889) include donated equipment and supplies received by various regions from the respective pass-through entity. Additionally, expenditures incurred for this program may exceed the amounts awarded from the respective pass-through entity. The amounts reported on the schedule of expenditures of federal and state awards are limited to the award amounts. Amounts in excess of this amount are paid out of nonfederal sources.

3. Subrecipients

Of the state expenditures related to the Family Practice Residency Program, CHRISTUS Health provided $114,246 to subrecipients.

CHRISTUS Health

Schedule of Findings and Questioned Costs

Year Ended June 30, 2008

Part I – Summary of Auditor's Results

Financial Statements Section

Type of auditor's report issued:	Unqualified	
	Yes	**No**
Internal control over financial reporting:		
Material weakness(es) identified?		X
Significant deficiency(ies) identified that are not considered to be material weaknesses?		None reported
Noncompliance material to financial statements noted?		X

Federal Awards Section	**Yes**	**No**
Internal control over major programs:		
Material weakness(es) identified?	X	
Significant deficiency(ies) identified that are not considered to be material weaknesses?	X	
Type of auditor's report issued on compliance for major program:	Unqualified for Special Supplemental Nutrition Program for Women, Infants, and Children; and Qualified for National Bioterrorism Hospital Preparedness Program	
Any audit findings disclosed that are required to be reported in accordance with Section .510(a) of OMB Circular A-133?	X	

CHRISTUS Health

Schedule of Findings and Questioned Costs (continued)

Part I – Summary of Auditor's Results (continued)

State Awards Section	**Yes**	**No**
Internal control over major programs:		
Material weakness(es) identified?	X	
Significant deficiency(ies) identified that are not considered to be material weaknesses?		X
Type of auditor's report issued on compliance for major programs:	Qualified	
Any audit findings disclosed that are required to be reported in accordance with Section .510(a) of Part IV of the State of Texas Uniform Grant and Contract Management Standards Act of 1981?	X	

CHRISTUS Health

Schedule of Findings and Questioned Costs (continued)

Part I – Summary of Auditor's Results (continued)

CFDA Number(s)	Name of Federal/State Program or Cluster
Identification of major federal programs:	
10.557	Special Supplemental Nutrition Program for Women, Infants, and Children
93.889	National Bioterrorism Hospital Preparedness Program
Identification of major state programs:	
Various	Family Practice Residency Program
Dollar threshold to distinguish between Type A and Type B programs:	$ 300,000

	Yes	No
Auditee qualified as low-risk auditee?		X

Part II – Financial Statement Findings Section

This section identifies the significant deficiencies, material weaknesses, fraud, illegal acts, violations of provisions of contracts and grant agreements, and abuse related to the consolidated financial statements for which *Government Auditing Standards* require reporting in a Circular A-133 audit.

No findings were noted.

Part III – Federal Award Findings and Questioned Costs Section

This section identifies the audit findings required to be reported by Circular A-133 Section .510(a) (for example, material weaknesses, significant deficiencies, and material instances of noncompliance, including questioned costs), as well as any abuse findings involving federal awards that are material to a major program.

Finding 08-1

Federal program information:

Federal Awarding Agency: United States Department of Health and Human Services (passed through to CHRISTUS Health from various pass-through entities)
Federal Program: National Bioterrorism Hospital Preparedness Program (Bioterrorism Program)
CFDA No.: 93.889

Federal Awarding Agency: United States Department of Health and Human Services (passed through to CHRISTUS Health from Biomedical Research Foundation of Northwest Louisiana)
Federal Program: Cooperative Agreements to Improve the Health Status of Minority Populations
CFDA No.: 93.004

Criteria or specific requirement:

Recipients of federal awards are to maintain adequate controls over their books and records in order to prepare appropriate financial statements, including the Schedule of Expenditures of Federal and State Awards (OMB Circular A-133, Section .300(d)).

Condition:

The System was not appropriately complying with the requirements to record transactions in the proper period for the Bioterrorism Program and to ensure that all expenditures for other federal programs are recorded on the schedule of expenditures of federal and state awards.

Questioned costs:

$11,666

Part III – Federal Award Findings and Questioned Costs Section (continued)

Finding 08-1 (continued)

Context:

As part of our expenditure testing to review a sample of expenditures incurred within the National Bioterrorism Hospital Preparedness Program for allowable costs and activities, we selected a sample of 25 individual amounts that were recorded on the Schedule of Expenditures of Federal and State Awards. Through inquiry and observation, it was noted that one of the expenditures selected for testing was incurred in the prior fiscal year and should not have been included in the current year Schedule of Federal Expenditures of Federal and State Awards.

Through our testing of the Schedule of Expenditures of Federal and State Awards, an additional grant was identified that was not previously recorded. CHRISTUS Health Central Louisiana received a grant in March 2008 and began incurring expenditures in May and June 2008. The grant was not initially identified and documented as a federal pass-through award, and the grant and its related expenditures during fiscal year 2008 were not captured in the Schedule of Expenditures of Federal and State Awards until near the end of the audit.

Effect:

The original Schedule of Expenditures of Federal and State Awards was not correct.

Cause:

CHRISTUS Health did not have adequate controls in place to record expenditures in the proper period on the Schedule of Expenditures of Federal and State Awards. CHRISTUS Health personnel did not have adequate controls in place to ensure that all grants and expenditures were properly recorded on the Schedule of Expenditures of Federal and State Awards.

Recommendation:

CHRISTUS Health should implement additional procedures and internal controls to ensure its Schedule of Expenditures of Federal and State Awards is prepared properly to include all federal expenditures and that the amounts are reported in the proper period.

Part III – Federal Award Findings and Questioned Costs Section (continued)

Finding 08-1 (continued)

Views of responsible officials and planned corrective actions:

See corrective action plan included in the reporting package.

Conclusion:

Based on the above, finding remains as stated.

Finding 08-2

Federal program information:

Federal Awarding Agency: United States Department of Health and Human Services
Federal Award Title: National Bioterrorism Hospital Preparedness Program (passed through to CHRISTUS Health from various pass-through entities)
CFDA No.: 93.889

Criteria or specific requirement:

OMB Circular A-110 Sections .40 through .48 state that the grant recipient shall perform certain procurement procedures including:

1. All procurement transactions shall be conducted in a manner to provide, to the maximum extent practical, open and free competition.

2. Ensure that small businesses, minority-owned firms, and women's business enterprises are used to the fullest extent practicable.

Part III – Federal Award Findings and Questioned Costs Section (continued)

Finding 08-2 (continued)

Criteria or specific requirement (continued):

3. Recipients shall, on request, make available for the federal awarding agency pre-award review and procurement documents, such as requests for proposals or invitations for bids, independent cost estimates, etc., when (among other things) the following has occurred: the procurement is expected to exceed the small purchase threshold fixed at 41 U.S.C. 403(11) ($25,000) and is to be awarded without competition or only one bid or offer is received in response to a solicitation.

4. Some form of cost or price analysis shall be made and documented in the procurement files in connection with every procurement action.

5. Procurement records and files for purchases in excess of the small purchase threshold shall include the following at a minimum:

    a. Basis for contractor selection.

    b. Justification for lack of competition when competitive bids or offers are not obtained.

    c. Basis for award cost or price.

6. Recipients of federal awards shall establish written procurement procedures. These procedures shall provide for, at a minimum, that:

    a. Recipients avoid purchasing unnecessary items.

    b. Where appropriate, an analysis is made of lease and purchase alternatives to determine which would be the most economical and practical procurement for the federal government.

Part III – Federal Award Findings and Questioned Costs Section (continued)

Finding 08-2 (continued)

Criteria or specific requirement (continued):

c. Solicitations for goods and services provide for all of the following:

   i. A clear and accurate description of the technical requirements for the material, product, or service to be produced. In competitive procurements, such a description shall not contain features which unduly restrict competition.

   ii. Requirements which the bidder/offeror must fulfill and all other factors to be used in evaluating bids and proposals.

   iii. A description, whenever practicable, of technical requirements in terms of functions to be performed or performance required, including the range of acceptable characteristics or minimum acceptable standards.

   iv. The specific features of "brand name or equal" descriptions that bidders are required to meet when such items are included in the solicitation.

   v. The acceptance, to the extent practicable and economically feasible, of products and services dimensioned in the metric system of measurement.

   vi. Preference, to the extent practicable and economically feasible, for products and services that conserve natural resources and protect the environment and are energy efficient.

Condition:

CHRISTUS Health did not perform the necessary federal procurement procedures as identified above. CHRISTUS Health failed to perform or maintain contract files, price analysis, bids, or basis for contractor selection, and the written procurement policies do not contain the minimum requirements of OMB Circular A-110.

Part III – Federal Award Findings and Questioned Costs Section (continued)

Finding 08-2 (continued)

Questioned costs:

$3,026

Context:

Based on inquiry of management and observation, it was noted that evidence was lacking to validate that the appropriate federal procurement procedures were performed, and the written procurement policies do not contain the minimum requirements of OMB Circular A-110.

Effect:

CHRISTUS Health is not in compliance with specific federal regulations related to procurements to ensure compliance with OMB Circular A-110 requirements identified above.

Cause:

CHRISTUS Health lacked sufficient/adequate procedures and controls related to federal procurements.

Recommendation:

CHRISTUS Health should review the appropriate OMB Circular A-110 federal requirements related to procurements and should establish procedures and controls to ensure procurements using federal funds are executed in accordance with the federal requirements.

Views of responsible officials and planned corrective actions:

See corrective action plan included in the reporting package.

Conclusion:

Based on the above, finding remains as stated.

Part III – Federal Award Findings and Questioned Costs Section (continued)

Finding 08-3

Federal program information:

Federal Awarding Agency: United States Department of Health and Human Services
Federal Award Title: Special Supplemental Nutrition Program for Women, Infants, and Children
CFDA No.: 10.557

Criteria or specific requirement:

OMB Circular A-110 Sections .40 through .48 state that the grant recipient shall perform certain procurement procedures including:

1. All procurement transactions shall be conducted in a manner to provide, to the maximum extent practical, open and free competition.

2. Ensure that small businesses, minority-owned firms and women's business enterprises are used to the fullest extent practicable.

3. Recipients shall, on request, make available for the federal awarding agency, pre-award review and procurement documents, such as request for proposals or invitations for bids, independent cost estimates, etc., when (among other things) the following has occurred:

    a. A recipient's procurement procedures or operation fails to comply with the procurement standards in the Federal awarding agency's implementation of this Circular.

    b. The procurement is expected to exceed the small purchase threshold fixed at 41 U.S.C. 403 (11) ($25,000) and is to be awarded without competition or only one bid or offer is received in response to a solicitation.

    c. The procurement, which is expected to exceed the small purchase threshold, specifies a "brand name" product.

Part III – Federal Award Findings and Questioned Costs Section (continued)

Finding 08-3 (continued)

Criteria or specific requirement (continued):

d. The proposed award over the small purchase threshold is to be awarded to other than the apparent low bidder under a sealed bid procurement

e. A proposed contract modification changes the scope of a contract or increases the contract amount by more than the amount of the small purchase threshold.

4. Some form of cost or price analysis shall be made and documented in the procurement files in connection with every procurement action.

5. Procurement records and files for purchases in excess of the small purchase threshold shall include the following at a minimum:

   a. Basis for contractor selection.

   b. Justification for lack of competition when competitive bids or offers are not obtained.

   c. Basis for award cost or price.

6. Recipients of federal awards shall establish written procurement procedures. These procedures shall provide for, at a minimum, that:

   a. Recipients avoid purchasing unnecessary items.

   b. Where appropriate, an analysis is made of lease and purchase alternatives to determine which would be the most economical and practical procurement for the federal government.

   c. Solicitations for goods and services provide for all of the following:

Part III – Federal Award Findings and Questioned Costs Section (continued)

Finding 08-3 (continued)

Criteria or specific requirement (continued):

i. A clear and accurate description of the technical requirements for the material, product or service to be produced. In competitive procurements, such a description shall not contain features which unduly restrict competition.

ii. Requirements which the bidder/offeror must fulfill and all other factors to be used in evaluating bids and proposals.

iii. A description, whenever practicable, of technical requirements in terms of functions to be performed or performance required, including the range of acceptable characteristics or minimum acceptable standards.

iv. The specific features of "brand name or equal" descriptions that bidders are required to meet when such items are included in the solicitation.

v. The acceptance, to the extent practicable and economically feasible, of products and services dimensioned in the metric system of measurement.

vi. Preference, to the extent practicable and economically feasible, for products and services that conserve natural resources and protect the environment and are energy efficient.

Condition:

CHRISTUS Health did not perform the necessary procurement procedures as identified above. For the Special Supplement Nutrition Program for Women, Infants, and Children, CHRISTUS Health's written procurement policies do not contain the minimum requirements of OMB Circular A-110.

Questioned costs:

None

Part III – Federal Award Findings and Questioned Costs Section (continued)

Finding 08-3 (continued)

<u>Context</u>:

Based on inquiry of management and observation, it was noted that for the Special Supplement Nutrition Program for Women, Infants, and Children, the written procurement policies do not contain the minimum requirements of OMB Circular A-110.

<u>Effect</u>:

CHRISTUS Health is not in compliance with specific federal regulations related to procurements to ensure compliance with OMB Circular A-110 requirements identified above.

<u>Cause</u>:

CHRISTUS Health lacked sufficient/adequate procedures and controls related to procurements.

<u>Recommendation</u>:

CHRISTUS Health should review the appropriate OMB Circular A-110 federal requirements related to procurements and should establish procedures and controls to ensure compliance with the federal requirements.

<u>Views of responsible officials and planned corrective actions</u>:

See corrective action plan included in the reporting package.

Part IV – State Award Findings and Questioned Costs Section

This section identifies the audit findings required to be reported by Section __.510(a) of the State of Texas Uniform Grant Management Standards, Part IV (for example, material weaknesses, significant deficiencies, and material instances of noncompliance, including questioned costs), as well as any abuse findings involving state awards that are material to a major program.

Finding 08-4

State program information:

State Awarding Agency: The Texas Higher Education Coordinating Board
State Award Title: Family Practice Residency Program

Criteria or specific requirement:

Section _.400(d) of the State of Texas Uniform Grant and Contract Management Standards Act of 1981, Part IV specifies that pass-through entities perform the following activities:

(1) Identify state awards made by informing each subrecipient of the state program name and state program number (if a number is used), CFDA title and number (if used to identify the state program), other relevant identifier, award name and number, award year and name of state agency. When some of this information is not available, the pass-through entity shall provide the best information available to describe the state award.

(2) Advise subrecipients of requirements imposed on them by state laws, regulations, and the provisions of contracts or grant agreements, as well as any supplemental requirements imposed by the pass-through entity. The requirements shall either be stated in the contracts or grant agreements, or be included by specific reference in the contracts or grant agreements.

(3) Monitor the activities of subrecipients as necessary to ensure that state awards are used for authorized purposes in compliance with laws, regulations, and the provisions of contracts or grant agreements and that performance goals are achieved.

Part IV – State Award Findings and Questioned Costs Section (continued)

Finding 08-4 (continued)

(4) Ensure that subrecipients expending $500,000 (for fiscal years ending after December 31, 2003) or more in state awards during the subrecipient's fiscal year have met the audit.

(5) Issue a management decision on audit findings within six months after receipt of the subrecipient's audit report and ensure that the subrecipient takes appropriate and timely corrective action.

(6) Consider whether subrecipient audits necessitate adjustment of the pass-through entity's own records.

(7) Require each subrecipient to permit the pass-through entity and auditors to have access to the records and financial statements as necessary for the pass-through entity to comply with this audit circular.

(8) When state awards are made with federal awards to a subrecipient, as required match, inform the subrecipient of the proportion of federal and state funds disbursed to the subrecipient to facilitate the subrecipient's separate calculations of expenditures of federal awards and state awards for its fiscal year.

(9) When state awards are made to a subrecipient to supplement federal awards, the state awards are not used to meet a federal matching requirement, and requirements of the state award differ from the requirements of the federal award (e.g., different activities are allowed or disallowed, or different allowable costs or cost principles are used), the pass through entity shall also provide information as to the amount of each award to the recipient at the time the award is made to facilitate the subrecipient's accounting for and compliance with the requirements of each award during the term of such award.

(10) Identify, at the time of award, any state awards made which are part of a state cluster of programs.

Part IV – State Award Findings and Questioned Costs Section (continued)

Finding 08-4 (continued)

Condition:

CHRISTUS St. Michael entered into an agreement dated January 15, 2008, with the Texas Higher Education Coordinating Board (the Board) to aid in the operation and maintenance of a family medicine residency program in Texas for the state year ending August 31, 2008. The funds for this program were provided by the Board directly to the Arkansas Health Education Centers (AHEC) for administration of the program. None of the pass-through entity responsibilities required under Section _.400(d) of the State of Texas Uniform Grant and Contract Management Standards Act of 1981, Part IV were performed. This grant was initially received by CHRISTUS St. Michael in 1996.

Questioned costs:

None.

Context:

CHRISTUS St. Michael entered into an agreement dated January 15, 2008 with the Texas Higher Education Coordinating Board (the Board) to aid in the operation and maintenance of a family medicine residency program in Texas. The funds for this program were provided by the Board directly to the Arkansas Health Education Centers (AHEC) for administration of the program. However, given that the agreement for the program was between CHRISTUS St. Michael and the Board, we inquired of management as to the performance of the pass-through entity responsibilities described in Section _.400(d) of the State of Texas Uniform Grant and Contract Management Standards Act of 1981, Part IV. We were advised that while CHRISTUS St. Michael had entered into an affiliation agreement with AHEC for the performance of certain activities related to the family medicine residency program, this agreement did not specifically communicate to AHEC or otherwise require compliance with the requirements mandated by the agreement between CHRISTUS St. Michael and the Board. Additionally, there was no monitoring performed during the period by CHRISTUS St. Michael of AHEC and their compliance with the requirements of the agreement. No controls were identified by management to monitor their compliance with the pass-through entity responsibilities of Section _.400(d) of the State of Texas Uniform Grant and Contract Management Standards Act of 1981, Part IV.

Part IV – State Award Findings and Questioned Costs Section (continued)

Finding 08-4 (continued)

Effect:

CHRISTUS St. Michael did not appropriately perform the pass-through entity responsibilities required under Section _.400(d) of the State of Texas Uniform Grant and Contract Management Standards Act of 1981, Part IV.

Cause:

CHRISTUS St. Michael did not have adequate control procedures in place to monitor the pass-through awards for the Family Practice Residency Program provided to AHEC and ensure that these procedures are adequately performed throughout the year.

Recommendation:

CHRISTUS St. Michael should establish control procedures to monitor the pass-through awards for the Family Practice Residency Program provided to AHEC and ensure that these procedures are adequately performed throughout the year.

Views of responsible officials and planned corrective actions:

See corrective action plan included in the reporting package.

Conclusion:

Based on the above, finding remains as stated.

CHRISTUS Health

A133 Single Audit Report: Corrective Action Plan
Year Ended June 30, 2008

Finding 08-1

Federal program information:

Federal Awarding Agency: United States Department of Health and Human Services (passed through to CHRISTUS Health from various pass-through entities)
Federal Program: National Bioterrorism Hospital Preparedness Program (Bioterrorism Program)
CFDA No.: 93.889

Federal Awarding Agency: United States Department of Health and Human Services ((passed through to CHRISTUS Health from Biomedical Research Foundation of Northwest Louisiana)
Federal Program: Cooperative Agreements to Improve the Health Status of Minority Populations
CFDA No.: 93.004

Criteria or specific requirement:

Recipients of federal awards are to maintain adequate controls over their books and records in order to prepare appropriate financial statements, including the Schedule of Expenditures of Federal and State Awards (OMB Circular A-133, Section .300(d)).

Condition:

The System was not appropriately complying with the requirements to record transactions in the proper period for the Bioterrorism Program and to ensure that all expenditures for other federal programs are recorded on the schedule of expenditures of federal and state awards.

Questioned costs:

$11,666

Context:

As part of our expenditure testing to review a sample of expenditures incurred within the National Bioterrorism Hospital Preparedness Program for allowable costs and activities, we selected a sample of 25 individual amounts that were recorded on the Schedule of Expenditures of Federal and State Awards. Through inquiry and observation, it was noted that one of the expenditures selected for testing was incurred in the prior fiscal year and should not have been included in the current year Schedule of Federal Expenditures of Federal and State Awards.

Through our testing of the Schedule of Expenditures of Federal and State Awards, an additional grant was identified that was not previously recorded. CHRISTUS Health Central Louisiana received a grant in March 2008 and began incurring expenditures in May and June 2008. The grant was not initially identified and documented as a federal pass-through award, and the grant and its related expenditures during fiscal year 2008 were not captured in the Schedule of Expenditures of Federal and State Awards until near the end of the audit.

Effect:

The original Schedule of Expenditures of Federal and State Awards was not correct.

Cause:

CHRISTUS Health did not have adequate controls in place to record expenditures in the proper period on the Schedule of Expenditures of Federal and State Awards. CHRISTUS Health personnel did not have adequate controls in place to ensure that all grants and expenditures were properly recorded on the Schedule of Expenditures of Federal and State Awards.

Recommendation:

CHRISTUS Health should implement additional procedures and internal controls to ensure its Schedule of Expenditures of Federal and State Awards is prepared properly to include all federal expenditures and that the amounts are reported in the proper period.

Views of responsible officials and planned corrective actions:

Management Directive 49 – Reporting Requirements for Government Grants was updated during FY08 to include all requirements for reporting of expenditures in the proper period. Corporate personnel responsible for monitoring and reporting of government grants conducted formal education programs for the operational and accounting personnel responsible for administering and recording government grants in the regions. During FY08, there were additional findings relating to recording grants in the proper period. One finding related to expenditures prior to the update of the management directive and education. The other finding was related to a grant that was not reported by the region until the audit was almost complete. Corporate personnel responsible for monitoring and reporting of government grants will conduct additional education for all personnel involved with government grant operations and reporting to ensure understanding of the requirements. In addition, a Regional Grant Coordinator will be designated for each region that will assist in coordinating and capturing all government grants to ensure proper reporting for the A133 Single Audit.

Contact Person:

Sandra Caruthers, Sr Manager-Tax, Payroll, AP
Regional Grant Coordinators

CHRISTUS Health

A133 Single Audit Report: Corrective Action Plan
Year Ended June 30, 2008

Estimated Completion Date:
November 30, 2008

Finding 08-2

Federal program information:

Federal Awarding Agency: United States Department of Health and Human Services
Federal Award Title: National Bioterrorism Hospital Preparedness Program (passed through to CHRISTUS Health from various pass-through entities)
CFDA No.: 93.889

Criteria or specific requirement:

OMB Circular A-110 Sections .40 through .48 state that the grant recipient shall perform certain procurement procedures including:

1. All procurement transactions shall be conducted in a manner to provide, to the maximum extent practical, open and free competition.

2. Ensure that small businesses, minority-owned firms, and women's business enterprises are used to the fullest extent practicable.

3. Recipients shall, on request, make available for the federal awarding agency pre-award review and procurement documents, such as requests for proposals or invitations for bids, independent cost estimates, etc., when (among other things) the following has occurred: the procurement is expected to exceed the small purchase threshold fixed at 41 U.S.C. 403(11) ($25,000) and is to be awarded without competition or only one bid or offer is received in response to a solicitation.

4. Some form of cost or price analysis shall be made and documented in the procurement files in connection with every procurement action.

5. Procurement records and files for purchases in excess of the small purchase threshold shall include the following at a minimum:

   a. Basis for contractor selection.

   b. Justification for lack of competition when competitive bids or offers are not obtained.

   c. Basis for award cost or price.

6. Recipients of federal awards shall establish written procurement procedures. These procedures shall provide for, at a minimum, that:

   a. Recipients avoid purchasing unnecessary items.

   b. Where appropriate, an analysis is made of lease and purchase alternatives to determine which would be the most economical and practical procurement for the federal government.

   c. Solicitations for goods and services provide for all of the following:

      i. A clear and accurate description of the technical requirements for the material, product, or service to be produced. In competitive procurements, such a description shall not contain features which unduly restrict competition.

      ii. Requirements which the bidder/offeror must fulfill and all other factors to be used in evaluating bids and proposals.

      iii. A description, whenever practicable, of technical requirements in terms of functions to be performed or performance required, including the range of acceptable characteristics or minimum acceptable standards.

      iv. The specific features of "brand name or equal" descriptions that bidders are required to meet when such items are included in the solicitation.

      v. The acceptance, to the extent practicable and economically feasible, of products and services dimensioned in the metric system of measurement.

      vi. Preference, to the extent practicable and economically feasible, for products and services that conserve natural resources and protect the environment and are energy efficient.

Condition:

CHRISTUS Health did not perform the necessary federal procurement procedures as identified above. CHRISTUS Health failed to perform or maintain contract files, price analysis, bids, or basis for contractor selection, and the written procurement policies do not contain the minimum requirements of OMB Circular A-110.

Questioned costs:

$3,026

CHRISTUS Health

A133 Single Audit Report: Corrective Action Plan
Year Ended June 30, 2008

Context:

Based on inquiry of management and observation, it was noted that evidence was lacking to validate that the appropriate federal procurement procedures were performed, and the written procurement policies do not contain the minimum requirements of OMB Circular A-110.

Effect:

CHRISTUS Health is not in compliance with specific federal regulations related to procurements to ensure compliance with OMB Circular A-110 requirements identified above.

Cause:

CHRISTUS Health lacked sufficient/adequate procedures and controls related to federal procurements.

Recommendation:

CHRISTUS Health should review the appropriate OMB Circular A-110 federal requirements related to procurements and should establish procedures and controls to ensure procurements using federal funds are executed in accordance with the federal requirements.

Views of responsible officials and planned corrective actions:

Management Directive 49 – Reporting Requirements for Government Grants was updated during FY08 to include OMB Circular A-110 Sections .40 through .48. A System Procurement Procedure – Purchasing Requirements for Government Grant Funding is under review and will be implemented for FY09. Corporate personnel provided education to procurement staff and Materials Management personnel during FY08 as well as to regional grant contact personnel. Additional education will be provided in FY09 to ensure understanding of the new System Procurement Procedure – Purchasing Requirements for Government Grant Funding by all personnel involved with procurement of items and regional contacts involved with government grant reporting. Corporate Accounting and System Procurement will work together to develop educational programs for both procurement personnel and regional grant contacts.

Contact Person:

Steve Pitzer, System Director, Supply Chain
Sandra Caruthers, Sr Manager-Tax, Payroll, AP

CHRISTUS Health

A133 Single Audit Report: Corrective Action Plan
Year Ended June 30, 2008

Estimated Completion Date:

October 31, 2008

Finding 08-3

Federal program information:

Federal Awarding Agency: United States Department of Health and Human Services
Federal Award Title: Special Supplemental Nutrition Program for Women, Infants, and Children
CFDA No.: 10.557

Criteria or specific requirement:

OMB Circular A-110 Sections .40 through .48 state that the grant recipient shall perform certain procurement procedures including:

1. All procurement transactions shall be conducted in a manner to provide, to the maximum extent practical, open and free competition.

2. Ensure that small businesses, minority-owned firms and women's business enterprises are used to the fullest extent practicable.

3. Recipients shall, on request, make available for the federal awarding agency, pre-award review and procurement documents, such as request for proposals or invitations for bids, independent cost estimates, etc., when (among other things) the following has occurred:

    a. A recipient's procurement procedures or operation fails to comply with the procurement standards in the Federal awarding agency's implementation of this Circular.

    b. The procurement is expected to exceed the small purchase threshold fixed at 41 U.S.C. 403 (11) ($25,000) and is to be awarded without competition or only one bid or offer is received in response to a solicitation.

    c. The procurement, which is expected to exceed the small purchase threshold, specifies a "brand name" product.

    d. The proposed award over the small purchase threshold is to be awarded to other than the apparent low bidder under a sealed bid procurement

e. A proposed contract modification changes the scope of a contract or increases the contract amount by more than the amount of the small purchase threshold.

4. Some form of cost or price analysis shall be made and documented in the procurement files in connection with every procurement action.

5. Procurement records and files for purchases in excess of the small purchase threshold shall include the following at a minimum:

   a. Basis for contractor selection.

   b. Justification for lack of competition when competitive bids or offers are not obtained.

   c. Basis for award cost or price.

6. Recipients of federal awards shall establish written procurement procedures. These procedures shall provide for, at a minimum, that:

   a. Recipients avoid purchasing unnecessary items.

   b. Where appropriate, an analysis is made of lease and purchase alternatives to determine which would be the most economical and practical procurement for the federal government.

   c. Solicitations for goods and services provide for all of the following:

      i. A clear and accurate description of the technical requirements for the material, product or service to be produced. In competitive procurements, such a description shall not contain features which unduly restrict competition.

      ii. Requirements which the bidder/offeror must fulfill and all other factors to be used in evaluating bids and proposals.

      iii. A description, whenever practicable, of technical requirements in terms of functions to be performed or performance required, including the range of acceptable characteristics or minimum acceptable standards.

      iv. The specific features of "brand name or equal" descriptions that bidders are required to meet when such items are included in the solicitation.

      v. The acceptance, to the extent practicable and economically feasible, of products and services dimensioned in the metric system of measurement.

vi. Preference, to the extent practicable and economically feasible, for products and services that conserve natural resources and protect the environment and are energy efficient.

Condition:

CHRISTUS Health did not perform the necessary procurement procedures as identified above. For the Special Supplemental Nutritional Program for Women, Infants, and Children, CHRISTUS Health's written procurement policies do not contain the minimum requirements of OMB Circular A-110.

Questioned costs:

None

Context:

Based on inquiry of management and observation, it was noted that for the Special Supplemental Nutritional Program for Women, Infants, and Children, the written procurement policies do not contain the minimum requirements of OMB Circular A-110.

Effect:

CHRISTUS Health is not in compliance with specific federal regulations related to procurements to ensure compliance with OMB Circular A-110 requirements identified above.

Cause:

CHRISTUS Health lacked sufficient/adequate procedures and controls related to procurements.

Recommendation:

CHRISTUS Health should review the appropriate OMB Circular A-110 federal requirements related to procurements and should establish procedures and controls to ensure compliance with the federal requirements.

Views of responsible officials and planned corrective actions:

See corrective action plan for 08-2

CHRISTUS Health

A133 Single Audit Report: Corrective Action Plan
Year Ended June 30, 2008

Contact Person:

Steve Pitzer, System Director, Supply Chain
Sandra Caruthers, Sr Manager-Tax, Payroll, AP

Estimated Completion Date:

October 31, 2008

Finding 08-4

State program information:

State Awarding Agency: The Texas Higher Education Coordinating Board
State Award Title: Family Practice Residency Program

Criteria or specific requirement:

Section _.400(d) of the State of Texas Uniform Grant and Contract Management Standards Act of 1981, Part IV specifies that pass-through entities perform the following activities:

(1) Identify state awards made by informing each subrecipient of the state program name and state program number (if a number is used), CFDA title and number (if used to identify the state program), other relevant identifier, award name and number, award year and name of state agency. When some of this information is not available, the pass-through entity shall provide the best information available to describe the state award.

(2) Advise subrecipients of requirements imposed on them by state laws, regulations, and the provisions of contracts or grant agreements, as well as any supplemental requirements imposed by the pass-through entity. The requirements shall either be stated in the contracts or grant agreements, or be included by specific reference in the contracts or grant agreements.

(3) Monitor the activities of subrecipients as necessary to ensure that state awards are used for authorized purposes in compliance with laws, regulations, and the provisions of contracts or grant agreements and that performance goals are achieved.

(4) Ensure that subrecipients expending $500,000 (for fiscal years ending after December 31, 2003) or more in state awards during the subrecipient's fiscal year have met the audit.

CHRISTUS Health

A133 Single Audit Report: Corrective Action Plan
Year Ended June 30, 2008

(5) Issue a management decision on audit findings within six months after receipt of the subrecipient's audit report and ensure that the subrecipient takes appropriate and timely corrective action.

(6) Consider whether subrecipient audits necessitate adjustment of the pass-through entity's own records.

(7) Require each subrecipient to permit the pass-through entity and auditors to have access to the records and financial statements as necessary for the pass-through entity to comply with this audit circular.

(8) When state awards are made with federal awards to a subrecipient, as required match, inform the subrecipient of the proportion of federal and state funds disbursed to the subrecipient to facilitate the subrecipient's separate calculations of expenditures of federal awards and state awards for its fiscal year.

(9) When state awards are made to a subrecipient to supplement federal awards, the state awards are not used to meet a federal matching requirement, and requirements of the state award differ from the requirements of the federal award (e.g., different activities are allowed or disallowed, or different allowable costs or cost principles are used), the pass through entity shall also provide information as to the amount of each award to the recipient at the time the award is made to facilitate the subrecipient's accounting for and compliance with the requirements of each award during the term of such award.

(10) Identify, at the time of award, any state awards made which are part of a state cluster of programs.

Condition:

CHRISTUS St. Michael entered into an agreement dated January 15, 2008, with the Texas Higher Education Coordinating Board (the Board) to aid in the operation and maintenance of a family medicine residency program in Texas for the state year ending August 31, 2008. The funds for this program were provided by the Board directly to the Arkansas Health Education Centers (AHEC) for administration of the program. None of the pass-through entity responsibilities required under Section _.400(d) of the State of Texas Uniform Grant and Contract Management Standards Act of 1981, Part IV were performed. This grant was initially received by CHRISTUS St. Michael in 1996.

Questioned costs:

None.

CHRISTUS Health

A133 Single Audit Report: Corrective Action Plan
Year Ended June 30, 2008

Context:

CHRISTUS St. Michael entered into an agreement dated January 15, 2008 with the Texas Higher Education Coordinating Board (the Board) to aid in the operation and maintenance of a family medicine residency program in Texas. The funds for this program were provided by the Board directly to the Arkansas Health Education Centers (AHEC) for administration of the program. However, given that the agreement for the program was between CHRISTUS St. Michael and the Board, we inquired of management as to the performance of the pass-through entity responsibilities described in Section _.400(d) of the State of Texas Uniform Grant and Contract Management Standards Act of 1981, Part IV. We were advised that while CHRISTUS St. Michael had entered into an affiliation agreement with AHEC for the performance of certain activities related to the family medicine residency program, this agreement did not specifically communicate to AHEC or otherwise require compliance with the requirements mandated by the agreement between CHRISTUS St. Michael and the Board. Additionally, there was no monitoring performed during the period by CHRISTUS St. Michael of AHEC and their compliance with the requirements of the agreement. No controls were identified by management to monitor their compliance with the pass-through entity responsibilities of Section _.400(d) of the State of Texas Uniform Grant and Contract Management Standards Act of 1981, Part IV.

Effect:

CHRISTUS St. Michael did not appropriately perform the pass-through entity responsibilities required under Section _.400(d) of the State of Texas Uniform Grant and Contract Management Standards Act of 1981, Part IV.

Cause:

CHRISTUS St. Michael did not have adequate control procedures in place to monitor the pass-through awards for the Family Practice Residency Program provided to AHEC and ensure that these procedures are adequately performed throughout the year.

Recommendation:

CHRISTUS St. Michael should establish control procedures to monitor the pass-through awards for the Family Practice Residency Program provided to AHEC and ensure that these procedures are adequately performed throughout the year.

Views of responsible officials and planned corrective actions:

CHRISTUS St. Michael will develop control procedures to monitor the pass-through awards received from THECB for the Texarkana-CHRISTUS St Michael Hospital Family Medicine Residency Program (FMRP). CHRISTUS St. Michael has designated Area Health Education

Centers (AHEC) to run the program providing education for FMRP. AHEC has run the program and has met the reporting requirements to THECB. The Affiliation Agreement between CHRISTUS St. Michael and AHEC will be amended to include the requirements for sub-recipients under Section _.400(d) of the State of Texas Uniform Grant and Contract Management Standards Act of 1981, Part IV. CHRISTUS St. Michael's control procedures will include the guidelines for monitoring the work performed by AHEC and for distribution of the grant funds to AHEC. CHRISTUS St. Michael has made arrangements for the funds from THECB to flow to CHRISTUS St. Michael. The Vice President of Medical Affairs will then distribute to AHEC upon receipt of documentation supporting the expenditures for the program. The Vice President of Medical Affairs will immediately begin oversight review of the required reports to THECB for the grant.

Contact Person:

Dr Michael Finley, CHRISTUS St. Michael Vice President of Medical Affairs
Sandra Caruthers, Sr Manger-Tax, Payroll, AP

Estimated Completion Date:

December 31, 2008

CHRISTUS Health

A133 Single Audit Report: Summary of Prior Year Findings
Year Ended June 30, 2008

Finding No. 07-1

Federal program information:	Federal Program: National Bioterrorism Hospital Preparedness Program CFDA No.: 93.889
Criteria or specific requirement (including statutory, regulatory, or other citation):	Recipients of federal awards are to maintain adequate controls over their books and records in order to prepare appropriate financial statements, including the Schedule of Expenditures of Federal and State Awards (OMB Circular A-133, Section .300(d)).
Condition:	CHRISTUS Health was not appropriately capturing donated equipment and other supplies on the Schedule of Expenditures of Federal and State Awards. Circular A-133 requires the recipient of federal awards to prepare a schedule of expenditures of federal awards for the period covered by the recipient's financial statements that includes, in either the schedule or a note to the schedule, the value of federal awards expended in the form of non-cash assistance.
Questioned Costs:	None. The Schedule of Expenditures of Federal and State Awards was revised to correct the identified error; thus, there are no questioned costs.
Context:	Ernst & Young noted the existence of donated equipment and other supplies through inquiry of CHRISTUS Health personnel responsible for monitoring the National Bioterrorism Hospital Preparedness Program within the Spohn region. Subsequent to our inquiries, management performed an analysis and included an additional $250,694 of donated equipment and other supplies in the Schedule of Expenditures of Federal and State Awards.
Effect:	The original Schedule of Expenditures of Federal and State Awards was not complete.

Cause:	CHRISTUS Health personnel at the region level were not familiar with the requirement to report donated equipment and other supplies on the Schedule of Expenditures of Federal and State Awards.
Recommendation:	CHRISTUS Health should implement additional procedures and internal controls to ensure its Schedule of Expenditures of Federal and State Awards is prepared properly to include all federal expenditures. Additionally, CHRISTUS Health should establish more detailed written procedures and education to ensure all personnel are aware of the federal requirements.
Corrective Action Plan:	Management Directive 49 – Reporting Requirements for Government Grants and the Grant Information and Tracking Document will be updated to include requirement for reporting donated supplies and equipment. Corporate personnel responsible for monitoring and reporting of government grants will develop an education program to ensure understanding of recording of donations of supplies and equipment originating from federal sources for the operations and accounting personnel responsible for administering and recording government grants in the regions.
Status at June 30, 2008:	Management Director 49 – Reporting Requirements for Government Grants was updated with an addendum to incorporate the reporting requirements for donated supplies and equipment. Corporate personnel responsible for monitoring and reporting of government grants conducted formal education programs for the operational and accounting personnel responsible for administering and recording government grants in the regions. The donated supplies and equipment were reported as required in FY08. In FY09 additional education will be provided to reinforce earlier training and to capture new staff involved in administering and reporting of government grants in the regions.

A133 Single Audit Report: Summary of Prior Year Findings
Year Ended June 30, 2008

Finding No. 07-2

Federal program information:	Federal Program: National Bioterrorism Hospital Preparedness Program CFDA No.: 93.889 Location: CHRISTUS Ark-La-Tex (St. Michael)
Criteria or specific requirement (including statutory, regulatory, or other citation):	Recipients of federal awards are to maintain adequate controls over their books and records in order to prepare appropriate financial statements, including the Schedule of Expenditures of Federal and State Awards (OMB Circular A-133, Section .300(d)).
Condition:	The System was not appropriately capturing federal expenditures in the proper period.
Questioned Costs:	None. The Schedule of Expenditures of Federal and State Awards was revised to correct the identified error; thus, there are no questioned costs.
Context:	As part of our expenditure testing to review a sample of expenditures incurred within the National Bioterrorism Hospital Preparedness Program for allowable costs and activities, we selected two individual amounts that were recorded on the Schedule of Expenditures of Federal Awards at CHRISTUS Ark-La-Tex (St. Michael). Through inquiry and observation, it was noted that these expenditures were incurred in the prior fiscal year and therefore should not have been included. We expanded our review, and through inquiry and observation, we noted that the total amount of expenditures included on the initial Schedule of Expenditures of Federal and State Awards of $11,473 was all incurred in the prior fiscal year. The Schedule of Expenditures of Federal and State Awards was revised to correct this error.
Effect:	The original Schedule of Expenditures of Federal and State Awards was not complete.

Cause:	CHRISTUS Health personnel at St. Michael did not have adequate controls in place to record these expenditures in the proper period on the Schedule of Expenditures of Federal and State Awards.
Recommendation:	CHRISTUS Health should implement additional procedures and internal controls to ensure its Schedule of Expenditures of Federal and State Awards is prepared properly to include all federal expenditures and that the amounts are reported in the proper period.
Corrective Action Plan:	Management Directive 49 – Reporting Requirements for Government Grants will be updated to include requirement for reporting of expenditures in the proper period. Corporate personnel responsible for monitoring and reporting of government grants will develop education program for the operations and accounting personnel in the regions responsible for administering and recording government grants to ensure understanding of the preparation of the Schedule of Expenditures of Federal and State Awards and amounts are reported in the proper period.
Status at June 30, 2008:	Management Directive 49 – Reporting Requirements for Government Grants was updated to include all requirements for reporting of expenditures in the proper period. Corporate personnel responsible for monitoring and reporting of government grants conducted formal education programs for the operational and accounting personnel responsible for administering and recording government grants in the regions. During FY08, there were additional findings relating to recording grants in the proper period so additional education will be provided to ensure understanding of the requirements. In addition, a Regional Grant Coordinator will be designated for each region who will assist in coordinating and capturing all government grants to ensure proper reporting for the A133 Single Audit.

Finding No. 07-3

Federal program information:	Federal Awarding Agency: United States Department of Health and Human Services Federal Award Title: National Bioterrorism Hospital Preparedness Program CFDA No.: 93.889
Criteria or specific requirement (including statutory, regulatory, or other citation):	OMB Circular A-110 Sections .40 through .48 state that the grant recipient shall perform certain procurement procedures including:

1. All procurement transactions shall be conducted in a manner to provide, to the maximum extent practical, open and free competition.

2. Ensure that small businesses, minority-owned firms, and women's business enterprises are used to the fullest extent practicable.
3. Recipients shall, on request, make available for the federal awarding agency pre-award review and procurement documents, such as requests for proposals or invitations for bids, independent cost estimates, etc., when (among other things) the following has occurred: the procurement is expected to exceed the small purchase threshold fixed at 41 U.S.C. 403(11) ($25,000) and is to be awarded without competition or only one bid or offer is received in response to a solicitation.

4. Some form of cost or price analysis shall be made and documented in the procurement files in connection with every procurement action.

5. Procurement records and files for purchases in excess of the small purchase threshold shall include the following at a minimum:

    a. Basis for contractor selection.

    b. Justification for lack of competition when competitive bids or offers are not obtained.

c. Basis for award cost or price.

6. Recipients of federal awards shall establish written procurement procedures. These procedures shall provide for, at a minimum, that:

    a. Recipients avoid purchasing unnecessary items.

    b. Where appropriate, an analysis is made of lease and purchase alternatives to determine which would be the most economical and practical procurement for the federal government.

    c. Solicitations for goods and services provide for all of the following:

        i. A clear and accurate description of the technical requirements for the material, product, or service to be produced. In competitive procurements, such a description shall not contain features which unduly restrict competition.

        ii. Requirements which the bidder/offeror must fulfill and all other factors to be used in evaluating bids and proposals.

        iii. A description, whenever practicable, of technical requirements in terms of functions to be performed or performance required, including the range of acceptable characteristics or minimum acceptable standards.

        iv. The specific features of "brand name or equal" descriptions that bidders are required to meet when such items are included in the solicitation.

        v. The acceptance, to the extent practicable and economically feasible, of products and services dimensioned in the metric system of measurement.

vi. Preference, to the extent practicable and economically feasible, for products and services that conserve natural resources and protect the environment and are energy efficient.

Condition:	CHRISTUS Health did not perform the necessary federal procurement procedures as identified above. CHRISTUS Health failed to perform or maintain contract files, price analysis, bids, or basis for contractor selection. CHRISTUS Health written procurement policies do not contain the minimum requirements of OMB Circular A-110.
Questioned Costs:	$24,403
Context:	Based on inquiry of management and observation, it was noted that evidence was lacking to validate that the appropriate federal procurement procedures were performed. It was also noted that CHRISTUS Health written procurement policies do not contain the minimum requirements of OMB Circular A-110.
Effect:	CHRISTUS Health is not in compliance with specific federal regulations related to procurements to ensure compliance with OMB Circular A-110 requirements identified above.
Cause:	CHRISTUS Health lacked sufficient/adequate procedures and controls related to federal procurements.
Recommendation:	CHRISTUS Health should review the appropriate OMB Circular A-110 federal requirements related to procurements and should establish procedures and controls to ensure procurements using federal funds are executed in accordance with the federal requirements.

Corrective Action Plan:	Management Directive 49 – Reporting Requirements for Government Grants will be updated to include the requirements from OMB Circular A-110 Sections .40 through .48 for procurement of items using federal funds. System Procurement will develop a system wide procurement policy that incorporates these requirements for procurement using federal funds. Corporate personnel responsible for monitoring and reporting of government grants will develop an education program to ensure understanding of the federal requirements relating to procurements with federal funds for the operations, procurement and accounting personnel in the regions.
Status at June 30, 2008:	Management Directive 49 – Reporting Requirements for Government Grants was updated to include OMB Circular A-110 Sections .40 through .48. A System Procurement Procedure – Purchasing Requirements for Government Grant Funding is under review and will be implemented for FY09. Corporate personnel responsible for monitoring and reporting of government grants provided education to Procurement and Materials Management personnel during FY08. Additional education will be provided in FY09 to ensure understanding of the new System Procurement Procedure – Purchasing Requirements for Government Grant Funding by all personnel involved with procurement of items and all regional government grant contacts.

Finding No. 07-4

Federal program information:	Federal Awarding Agency: United States Department of Health and Human Services Federal Award Title: National Bioterrorism Hospital Preparedness Program CFDA No.: 93.889
Criteria or specific requirement (including statutory, regulatory, or other citation):	OMB Circular A-110 section .34 states: "(f) The recipient's property management standards

for equipment acquired with Federal funds and federally-owned equipment shall include all of the following.

(1) Equipment records shall be maintained accurately and shall include the following information.

(i) A description of the equipment.
(ii) Manufacturer's serial number, model number, Federal stock number, national stock number, or other identification number.
(iii) Source of the equipment, including the award number.
(iv) Whether title vests in the recipient or the Federal Government.
(v) Acquisition date (or date received, if the equipment was furnished by the Federal Government) and cost.
(vi) Information from which one can calculate the percentage of Federal participation in the cost of the equipment (not applicable to equipment furnished by the Federal Government).
(vii) Location and condition of the equipment and the date the information was reported.

(viii) Unit acquisition cost.
(ix) Ultimate disposition data, including date of disposal and sales price or the method used to determine current fair market value where a recipient compensates the Federal awarding agency for its share.

(2) Equipment owned by the Federal Government shall be identified to indicate Federal ownership.

(3) A physical inventory of equipment shall be taken and the results reconciled with the equipment records at least once every two years. Any differences between quantities determined

by the physical inspection and those shown in the accounting records shall be investigated to determine the causes of the difference. The recipient shall, in connection with the inventory, verify the existence, current utilization, and continued need for the equipment.

(4) A control system shall be in effect to insure adequate safeguards to prevent loss, damage, or theft of the equipment. Any loss, damage, or theft of equipment shall be investigated and fully documented; if the equipment was owned by the Federal Government, the recipient shall promptly notify the Federal awarding agency.

(5) Adequate maintenance procedures shall be implemented to keep the equipment in good condition.

(6) Where the recipient is authorized or required to sell the equipment, proper sales procedures shall be established which provide for competition to the extent practicable and result in the highest possible return."

Condition: Equipment records do not contain all required information per OMB Circular A-110.

Questioned Costs: None.

Context: For a sample of equipment purchases from throughout various regions of CHRISTUS Health, we noted equipment records in the Santa Rosa, St. John, and St. Catherine facilities do not contain the following required information per OMB Circular A-110:

- Manufacturer's serial number, model number, Federal stock number, national stock number, or other identification number.
- Whether title vests in the recipient or the Federal Government.
- Location and condition of the equipment and the date the information was reported.

	As part of our audit procedures, we did verify that assets listed did exist as described in the fixed asset subledger.
Effect:	CHRISTUS Health is not in compliance with equipment management compliance requirements defined in OMB Circular A-110 throughout all regions.
Cause:	CHRISTUS Health personnel at the Santa Rosa, St. John, and St. Catherine facilities levels were not familiar with the documentation requirements related to equipment and real property management per OMB Circular A-110.
Recommendation:	Management should implement policies and procedures to ensure records throughout CHRISTUS Health contain information in accordance with the federal equipment management requirements.
Corrective Action Plan:	Management Directive 49 – Reporting Requirements for Government Grants will be updated to include the requirements from OMB Circular A-110 Section .34 for recording acquisition of capital assets with federal funds and requirements for physical inventory counts at least every two years. The Grant Information and Tracking Document will be updated to include reporting of all required elements of capital assets acquired with federal funds and tracking of physical inventory counts. Corporate personnel responsible for monitoring and reporting of government grants will develop education program for the operations and accounting personnel responsible for administering and recording government grants in the regions to ensure understanding of the requirements relating to recording of capital assets acquired with federal funds and physical inventory requirements.
Status at June 30, 2008:	Management Directive 49 – Reporting Requirements for Government Grants and Grant Information and Tracking documents were updated to incorporate capital asset requirements from OMB Circular A-

110 Section .34. The requirement for a physical inventory every 2 years was included. Corporate personnel responsible for monitoring and reporting of government grants conducted an education program to further the understanding of these requirements. The Capital Tracking Documents were completed with the required elements and the physical inventories were taken as required.

Finding No. 07-5

Federal program information:	Federal Awarding Agency: United States Department of Health and Human Services Pass-through Agency: Coastal Bend Regional Advisory Council – Area U CFDA No.: 93.889 Region: CHRISTUS Spohn (Memorial, Shoreline, South, Kleberg, Beeville, Alice) Award No.: various Award Year: various
Criteria or specific requirement (including statutory, regulatory, or other citation):	Cash Management – Funds Disbursement
Condition:	Per OMB Circular A-110, Subpart C, Section_.22(a), "Payment methods shall minimize the time elapsing between the transfer of funds from the United States Treasury and the issuance or redemption of checks, warrants, or payment by other means by the recipients." Of the amount expended during the current fiscal year by CHRISTUS Spohn, we noted that for approximately $19,000, the advance was received between June and December 2004; therefore, there were no procedures in place to minimize the time elapsing between the transfer of fund and the disbursement by CHRISTUS Spohn for program purposes. We further noted for the remaining amounts received by CHRISTUS Spohn under the Bioterrorism program, there was an additional $104,000 that was received between June 2004 and September 2006 that had not been spent as of June 30, 2007. Therefore, for this amount, there

	were also no procedures in place to minimize the time elapsing between the transfer of funds and the disbursement by CHRISTUS Spohn for program purposes.
Questioned Costs:	None.
Context:	We reviewed a listing of all cash receipts (either individually or in the aggregate). There were 44 items included in this listing; therefore, a sample of five amounts was selected for testing. We obtained a bank statement to support the date when these funds were deposited. We then reviewed the general ledger expense detail for the selected items to determine the approximate dates when these funds were expended for program purposes by CHRISTUS Spohn. Of the five items selected for testing, the two amounts selected from CHRISTUS Spohn were deposited into the bank account in 2004 and were not expended until fiscal year 2007. We then inquired and obtained from management a schedule of all amounts received via advance by CHRISTUS Spohn. By comparing the dates when these amounts were received to the dates when these amounts were expended for program purposes, we noted that only \$9,630 of the \$132,594 total received was spent for program purposes in a minimally elapsed time period from when the funds were received.
Effect:	CHRISTUS Health was not in compliance with federal guidelines.
Cause:	Management did not have procedures in place at CHRISTUS Spohn to minimize the time period between when funds were received from the pass-through entity and when funds were ultimately spent for program purposes.
Recommendation:	Establish procedures so as to comply with federal regulations.
Corrective Action Plan:	Management Directive 49 – Reporting Requirements for Government Grants will be updated to include

the requirements from OMB Circular A-133 Subpart C, Section .22(a) to minimize the time period between when funds are received from pass through entities and when the funds are ultimately spent. Corporate personnel responsible for monitoring and reporting of government grants will develop an education program for the operations and accounting personnel responsible for administering and recording government grants in the regions to ensure understanding of the requirement to minimize the time period between receipt of federal funds and expenditure of the funds.

Status at June 30, 2008: Management Directive 49 – Reporting Requirements for Government Grants was updated for the needed requirements. Corporate personnel responsible for monitoring and reporting of government grants conducted an education program to ensure understanding of the requirement to minimize the time between receipt of funds and expenditure. Advanced funds were expended within the required timelines in FY08.