Bexar County Hospital District
d/b/a University Health System
A Component Unit of Bexar County, Texas

Independent Auditor's Reports and Financial Statements

December 31, 2017 and 2016

BKD LLP
CPAs & Advisors

Bexar County Hospital District
d/b/a University Health System
A Component Unit of Bexar County, Texas
December 31, 2017 and 2016

Contents

BKD LLP
CPAs & Advisors

14241 Dallas Parkway, Suite 1100 // Dallas, TX 75254-2961
972.702.8262 // fax 972.702.0673 // bkd.com

Independent Auditor's Report

Board of Managers
Bexar County Hospital District
d/b/a University Health System
San Antonio, Texas

Report on the Financial Statements

We have audited the accompanying financial statements of the business-type activities, the discretely presented component unit and the aggregate remaining fiduciary fund information of Bexar County Hospital District d/b/a University Health System (the System), collectively a component unit of Bexar County, Texas, as of and for the years ended December 31, 2017 and 2016, and the related notes to the financial statements, which collectively comprise the System's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audits. We did not audit the financial statements of University Health System Pension Plan (the Pension Plan), a fiduciary fund of the System. Those statements were audited by other auditors, whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for the Pension Plan, is based solely on the report of the other auditors. We conducted our audits in accordance with auditing standards generally accepted in the United States of America 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 from material misstatement. The financial statements of the Pension Plan and Community First Health Plans, which are included in the System's financial statements, were not audited in accordance with *Government Auditing Standards.*

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

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

Opinions

In our opinion, based on our audits and the report of the other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities, the discretely presented component unit and the aggregate remaining fiduciary fund information of the System as of December 31, 2017 and 2016, and the respective changes in financial position and, where applicable, cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in *Note 10* to the financial statements, in 2017, the System adopted GASB Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans* by applying the provisions of the Statement retrospectively to 2016. Our opinions are not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis, pension information and other postretirement benefits information listed in the table of contents be presented to supplement the basic financial statements. Such information, although not part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. We and the other auditors have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements and other knowledge we obtained during our audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audits were conducted for the purpose of forming an opinion on the financial statements that collectively comprise the System's basic financial statements. The report of management responsibility information as listed in the table of contents is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audits of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated May 23, 2018, on our consideration of the System'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* in considering the System's internal control over financial reporting and compliance.

BKD, LLP

Dallas, Texas
May 23, 2018

Bexar County Hospital District
d/b/a University Health System
A Component Unit of Bexar County, Texas
Management's Discussion and Analysis
Years Ended December 31, 2017 and 2016
(In Thousands)

Introduction

This management's discussion and analysis of the financial performance of Bexar County Hospital District d/b/a University Health System (the System) provides an overview of the System's financial activities for the years ended December 31, 2017 and 2016. It should be read in conjunction with the financial statements of the System.

The System continues to pursue its strategic vision to be the premier health system in south Texas, committed to delivering patient-centered, culturally competent and high quality health care, based on a strong foundation of outcomes-based research and innovative teaching. This vision guides decision-making and operational execution. The Triple-Aim *Plus* concept continues to be the guiding principles of how the System executes its strategy to serve the community. The System continues to be successful in executing the aims of: improving quality, safety and outcomes; improving the patient experience; improving efficiencies and improving access to care. These principles are the foundation of health care transformation and all initiatives pursued are developed in the spirit of transforming care using the Triple-Aim *Plus* goals.

2017 Highlights

A host of significant accomplishments in 2017 are already directly and positively impacting the patients served and positioning the System to effectively meet the challenges and opportunities related to health care reform and the Texas Transformation and Quality Improvement Program 1115 Waiver (the Waiver). Highlights of key initiatives and their outcomes relative to Triple-Aim *Plus* include:

Quality, Safety and Outcomes

- Ranked by U.S. News & World Report as the #1 best hospital in the San Antonio metro area for the seventh year in a row, the twelfth best hospital in Texas, and among the top 50 nationally in gynecology.
- Received verification by the American College of Surgeons as a Level I adult trauma center and Level I pediatric trauma and burn center. University Hospital serves the 22-county trauma region of South Texas as the only pediatric trauma center, and one of two Level I adult trauma centers, thanks to our partnership with Brooke Army Medical Center.
- Designation as a Level IV neonatal intensive care unit by the Texas Department of State Health Services. Level IV signifies the highest level of care available for premature and very sick babies.
- Certified by the by the American Heart Association/American Stroke Association for the Get With The Guidelines-Stroke Gold Plus and Target: Stroke Elite Plus Award.
- Recognized by the American Heart Association as a 2017 Mission: Lifeline STEMI Receiving Center — Silver Achievement Award hospital.
- Received full Chest Pain Accreditation, certified by The American College of Cardiology as a Chest Pain with Percutaneous Coronary Intervention Center.

- Received recognition from *Hospitals & Health Networks* as a "Most Wired" institution in its annual survey - an industry-standard benchmark for measuring meaningful use adoption of health care information technology.

The Patient Experience

- There is a direct link between the level of an employee's engagement and his/her performance. This is especially critical in a high-stakes healthcare organization. In response to staff surveys we enhanced internal communications in 2017, including a revamped weekly printed and online/emailed newsletter, Weekly InfoHuddles across the organization, Town Hall Meetings, text messaging capability, leadership education on communicating with employees, and a reduction in the one-off emails. The result was a 10% improvement in staff survey responses for the "would definitely recommend as a place to work" question, which is now 27% higher than the national average. Patient experience survey responses are also above national averages. The Health System ended 2017 with 81.5% of our hospital patients saying they "would definitely recommend" University Hospital to friends and family (73rd percentile nationally).
- In a related consideration to patient experience, the health system is performing well in consumer preference surveys conducted by third party research groups. In 2017, University Health System improved unaided brand awareness among potential patients, as well as its overall brand image and preference indicators. The System ended the year as the "Most Preferred for all Health Needs" in the highly regarded NRC Market Insights Consumer Study, and had the highest "Best Image/Reputation" score in the market.

Efficiencies

- The System either met or was able to carry-forward all DSRIP milestones due in 2017 under the Waiver. Some carry-forward results were able to be reported as successful in the following reporting period.
- Integrated lean management continues to be expanded through training initiatives to all levels of staff and incorporated in weekly rounding discussions in operational and financial departments.
- The System developed and implemented service line daily benchmark reports for activity and labor productivity.

Access to Care

- Celebrated 100 years of service to our community from when the Robert B. Green Memorial Hospital opened its doors to patients in February 1917.
- Received Board of Managers and Bexar County Commissioner Court approval to proceed with the development of a new Women's and Children's Tower at University Hospital along with a new heart, vascular and advanced endoscopy center.
- The System opened a new ambulatory location on San Antonio Eastside. The Dr. Robert L.M. Hilliard Center, named for a well-known community OB/GYN who recently passed away, was met with an enthusiastic response from the community.
- Celebrated the 20th anniversary of CareLink, a financial assistance program for qualified Bexar County residents.
- Supported the region's disaster response during Hurricane Harvey participating in the Southwest Regional Advisory Council's Regional Medical Operations Center and accepted medical evacuees from the affected areas.
- The Level I trauma center at University Hospital activated its mass casualty protocol and cared for nine of the patients who were injured in the Sutherland Springs church shooting in November 2017. The team received significant national and international recognition for its skilled and compassionate handling of this tragedy.

Financial Highlights

- The System's net position increased by $54.4 million or 5.1% in 2017 and increased by $81.8 million or 8.3% in 2016. The increase in net position in both years is primarily due to increases in operating revenue and property tax revenue as discussed below.
- During 2017, the System's total operating revenue increased by $110.7 million or 8.9%, while total operating expenses increased by $182.3 million or 12.1%. During 2016, the System's total operating revenue increased by $140.9 million or 12.9%, while total operating expenses increased by $165.5 million or 12.4%.
- The System invested $52.7 million in capital assets in 2017 and $78.5 million in 2016, as part of the ongoing Capital Improvement Plan.

Financial Analysis of the System

The balance sheets and the statements of revenue, expenses, and changes in net position report information about the System's financial activities. These two statements report the net position of the System and changes in the net position. Increases or decreases in the System's net position are one indicator of whether its financial health is improving or deteriorating. However, other nonfinancial factors such as changes in economic conditions, population growth, growth in the number of uninsured and working poor, taxable property values and tax rates, and new or changed state and federal government funding should also be considered.

A summary of the System's balance sheets is presented in Table 1 as follows:

TABLE 1
Condensed Balance Sheets

	2017	2016	2015
Assets			
Current and other assets	$ 1,446,127	$ 1,330,439	$ 1,186,524
Capital assets, net	1,169,022	1,199,289	1,200,256
Total assets	2,615,149	2,529,728	2,386,780
Deferred Outflows of Resources	75,423	52,367	23,149
Total assets and deferred outflows of resources	$ 2,690,572	$ 2,582,095	$ 2,409,929
Liabilities			
Long-term debt	$ 670,082	$ 703,770	$ 711,941
Net pension liability	166,683	139,998	118,348
Other liabilities	303,311	274,431	230,501
Total liabilities	1,140,076	1,118,199	1,060,790
Deferred Inflows of Resources	430,984	398,797	365,798
Net Position			
Net investment in capital assets	507,471	502,112	500,834
Restricted - expendable	40,037	22,295	30,787
Unrestricted	572,004	540,692	451,720
Total net position	1,119,512	1,065,099	983,341
Total liabilities, deferred inflows of resources and net position	$ 2,690,572	$ 2,582,095	$ 2,409,929

As seen in Table 1, net position increased by $54.4 million in 2017. The increase in net position results primarily from an increase in patient service revenue attributable to growth in inpatient and outpatient services for adults and pediatrics. Additionally, growth in Community First Health Plans, Inc. (CFHP) covered members and service lines contributed to an increase in premium revenue. Property tax revenue, which is reflected as a component of nonoperating revenues, also increased significantly from prior year and is attributable to higher property values in Bexar County as well as taxes on new property values. Net position increased by $81.8 million to $1.1 billion in 2016, up from $983.3 million in 2015.

Summary of Revenues, Expenses and Changes in Net Position

The following table presents a summary of the System's historical revenues and expenses for each of the fiscal years ended December 31, 2017, 2016 and 2015:

TABLE 2
Condensed Statements of Revenues, Expenses and Changes in Net Position

	2017	2016	2015
Operating Revenues			
Net patient service revenue	$ 769,459	$ 754,014	$ 693,220
Premium revenue	496,472	391,048	328,389
Other revenue	81,498	91,691	74,210
Total operating revenues	1,347,429	1,236,753	1,095,819
Operating Expenses			
Salaries and employee benefits	564,395	526,309	474,668
Medical claims expense	450,462	336,398	282,252
Purchased services, supplies and other	587,409	560,630	498,643
Depreciation	82,526	79,119	81,418
Total operating expenses	1,684,792	1,502,456	1,336,981
Operating Loss	(337,363)	(265,703)	(241,162)
Nonoperating Revenues, Net	391,776	347,461	312,161
Increase in Net Position	$ 54,413	$ 81,758	$ 70,999

Sources of Revenues

Table 3 presents a summary of the System's historical sources of gross revenues:

TABLE 3
Sources of Gross Revenue by Percentage

	2017	2016	2015
Operating Revenues			
Net patient service revenue	44.3%	48.1%	49.2%
Premium revenue	28.5%	24.4%	23.3%
Other revenue	4.7%	5.7%	5.3%
Total operating revenues	77.5%	78.3%	77.8%
Nonoperating Revenues (Expenses)			
Investment return	0.5%	0.2%	0.2%
Interest expense	-1.9%	-2.2%	-2.7%
Debt issuance costs	0.0%	-0.1%	0.0%
Gain on sale of equity investment	0.0%	0.0%	0.6%
Property tax revenue, net	23.0%	22.9%	23.1%
Proceeds from tobacco settlement	0.4%	0.3%	0.4%
Build America Bond interest subsidy	0.5%	0.5%	0.6%
Total nonoperating revenues, net	22.5%	21.6%	22.2%
Total revenues	100%	100%	100%

Operating Revenues

During 2017, the System derived approximately 77.5% of its total revenue from operating revenues, compared to 78.3% in 2016 and 77.8% in 2015. In 2017, the percentage of total operating revenue generated from premium revenue increased due to increased membership in CFHP.

Table 4 presents the relative percentages of gross charges billed for patient services by payer for the fiscal years ended December 31, 2017, 2016 and 2015:

TABLE 4
Payer Mix by Percentage

	Year Ended December 31,		
	2017	2016	2015
Medicare	25%	25%	24%
Medicaid	24	24	23
Self-pay	25	24	26
Commercial insurance	25	26	26
Other	1	1	1
Total	100%	100%	100%

Nonoperating Revenues

During 2017, the System derived 23.0% of its total revenues from ad valorem taxes (property taxes), compared to 22.9% in 2016 and 23.1% in 2015. The Bexar County Commissioners Court is authorized to levy taxes on property within Bexar County to provide for the maintenance and operations of the System's facilities and for debt service on approved debt issuances.

For the years ended December 31, 2017, 2016 and 2015, investment return comprised 0.5%, 0.2% and 0.2%, respectively, of total revenue and was made up of interest income, net realized gains/losses and net unrealized market gains/losses.

For the years ended December 31, 2017, 2016 and 2015, tobacco revenue comprised 0.4%, 0.3% and 0.4%, respectively, of total revenues and represented the System's allocation of earnings on the state's permanent trust funds from a settlement with tobacco companies in 1998.

For the years ended December 31, 2017, 2016 and 2015, the Build America Bonds (BABs) interest subsidy comprised 0.5%, 0.5% and 0.6%, respectively, of total revenues and was made up of funds paid by the U.S. Treasury to subsidize interest costs on the BABs bond issuances.

Operating and Financial Performance

Overall activity of the System, as measured by patient discharges adjusted for outpatient activity, increased 7.5% to 59,007 in 2017 from 54,907 in 2016. In 2017, net patient service revenue increased by $15.4 million to $769.5 million or 2.0% due primarily to increased volume.

In 2017, premium revenue increased by $105.4 million to $496.5 million or 27.0%. This increase is attributable to growth in membership due to the STAR Kids line of business, which is the new Medicaid product for disabled children.

In 2017, other operating revenue decreased by $10.2 million to $81.5 million or 11.1%. This decrease is primarily attributable to a decrease in capitation payments received by CFHP related to the Network Access Improvement Program (NAIP). There is a comparable decrease in operating expenses associated with decreased NAIP incentive payments to participating providers. Overall, total operating revenue of $1.3 billion increased $110.7 million or 8.9% in 2017 compared to the total of $1.2 billion in 2016 that increased by $140.9 million or 12.9%. The increase in both years is attributable to the increase in net patient service revenue and premium revenue discussed above.

Employee compensation increased by $38.1 million or 7.2% in 2017 and $51.6 million or 10.9% in 2016. The increases are attributed to increased staffing due to increased activity in the hospital and clinic expansion initiatives.

Medical claims expense increased by $114.1 million or 33.9% in 2017 and $54.1 million or 19.2% in 2016. Increases in both years are attributable to increases in membership.

Purchased services, supplies and other expenses had an overall increase of $26.8 million or 4.8% in 2017 and an overall increase of $62.0 million or 12.48% in 2016. Of this amount, purchased services increased by $13.1 million or 6.1% in 2017. The increases are attributed to maintenance costs for equipment and increased activity in the hospital and clinic expansion initiatives.

Depreciation expense increased by $3.4 million or 4.3% in 2017 and decreased by $2.3 million or 2.8% in 2016. The 2017 increase in depreciation expense is a result the System brining completed projects into operations throughout 2016 and 2017. The 2016 decrease in depreciation expense is a result of a number of short-lived assets (such as equipment and information technology related expenditures) reaching the end of their useful lives.

Overall, total operating expenses increased by $182.3 million to $1.7 billion or 12.1% in 2017 and by $165.5 million to $1.5 billion or 12.4% in 2016.

Overall, nonoperating revenues (expenses) of $391.8 million increased by $44.3 million or 12.8% from 2016. Nonoperating revenues (expenses) consists of property tax revenue, investment income, proceeds from the tobacco settlement (the settlement of litigation between the State Attorney General and various tobacco companies), BAB subsidy payments, interest expense on bonds and debt issuance costs.

In 2017, property taxes were levied to support maintenance and operations and debt service. Overall property taxes increased by $32.7 million to $399.7 million compared to the 2016 taxes of $366.9 million. Of the $399.7 million, $341.8 million was to support maintenance and operations. The remaining $57.9 million in property tax revenue is a debt service property tax to fund the payment of principal and interest (debt service) on the Certificates of Obligation issued in 2008, 2009, 2010, and 2015 and the Limited Tax Refunding Bonds, Series 2016.

Capital Assets and Long-term Debt

During fiscal years 2017 and 2016, the System invested $52.7 million and $78.5 million, respectively, in a broad range of capital assets. Table 5 presents an analysis of capital asset balances between 2017, 2016 and 2015:

TABLE 5
Capital Assets

	2017	2016	2015
Land and land improvements	$ 20,906	$ 20,864	$ 19,449
Building and improvements	1,368,375	1,337,686	1,299,977
Equipment	451,613	413,108	390,101
Construction in progress	5,983	29,610	17,237
	1,846,877	1,801,268	1,726,764
Less accumulated depreciation	677,855	601,979	526,508
Capital assets, net of accumulated depreciation	$ 1,169,022	$ 1,199,289	$ 1,200,256

Construction in progress (CIP) decreased by $23.6 million in 2017. Other capital assets increased $69.2 million related to ongoing capital requirements such as clinical equipment, information system and facility expansion.

CIP increased by $12.4 million in 2016. Other capital assets increased $62.1 million related to ongoing capital requirements such as clinical equipment and information systems.

In August 2016, the System advance refunded $215.5 million of the combination tax and revenue Certificates of Obligation, Series 2008 Certificates with the issuance of the Limited Tax Refunding Bonds, Series 2016. Long-term debt transactions in 2017 and 2016 are discussed more fully in *Note 8*. As discussed in *Note 17*, the System issued $238,565 in combination tax and revenue Certificates of Obligation subsequent to year-end to fund new construction projects and facility improvements.

Economic Factors and Key Challenges

The System continues to serve as the anchor facility under the Waiver for RHP 6 which is comprised of 22 counties. A RHP plan was developed to understand and address health care needs throughout the RHP region and to develop a regional health care model focused on improving the experience of care for patients and their families, improving the health of the region, and reducing the cost of care without compromising quality. The RHP plan continues to be implemented and monitored to document improved access to care for individual and population health at a lower cost, delivered more efficiently.

Staff and the Board of Managers continue to monitor and consider many factors that have a direct or indirect impact on future operations of the System that include the following:

- The Waiver was originally effective from December 12, 2011 to September 30, 2016 and extended through December 2017 as HHSC and the Centers for Medicare and Medicaid Services (CMS) negotiated a longer term extension. On December 31, 2017, HHSC received an approved extension from CMS for the period of January 1, 2018 through September 30, 2022. Among other changes, the approved plan limits UC Pool funding to the cost of providing charity care and requires a phase out of the DSRIP program over the five year period.
- Growing activity and improving operating efficiencies
- Achieving the metrics for the 1115 Waiver projects
- Continue executing the Pediatric Transition Plan Mitigating the impact of changes to state and federal funding sources
- Determining the impact of changes to the Affordable Care Act

Strategic Plans to Meet These Challenges

- Continuing to maximize the Lean Management System (LMS) aimed at:
  - Incorporating lean continuous process improvement principles and techniques into daily management processes to deliver value to our patients with minimum wasted time, supplies and effort
  - Facilitating rapid improvements
  - Executing across all operational and support departments as well as across hospital and ambulatory services
  - Assuring a mechanism is in place to develop, sustain and improve processes over time
- Design and develop plan to convert existing EMR to the fully integrated Epic platform
- Development of a solution for System dialysis and clinic services.
- Continued construction activities on the main campus to accommodate our growing pediatric service line.
- Implementing strategic tactics to fulfill projected activity by:
  - Focusing on key service lines
    - Trauma
    - Transplant
    - Cardiovascular
    - Neurosciences
    - Pediatrics / Children’s Health
    - Women’s Health Services including perinatal and neonatal care
    - Oncology
  - Enhancing marketing, outreach and referral development
  - Executing planned clinical integration and physician alignment initiatives with key service line physicians

  - Planning, design and construction of a new Women’s and Children’s Tower with a completion date in 2022
- Leveraging current technology, data and tools
- Enhancing human capital through recognition programs and continuous learning
- Produce positive financial results in order to prefund our annual capital budget (currently routine capital expenditures are funded in the year the capital is expended).

Contacting the System’s Financial Manager

This financial report is designed to provide our citizens, customers, bond holders, and creditors with a general overview of the System’s finances and to demonstrate the System’s accountability for the money it receives. The report is available at www.universityhealthsystem.com. If you have questions about this report or need additional financial information, contact the System’s Financial Offices at 4502 Medical Drive, San Antonio, Texas 78229.

University Hospital
4502 Medical Drive
San Antonio, TX 78229

University Health System
www.UniversityHealthSystem.com

University Hospital

University Health Center – Downtown

University Center for Community Health / Texas Diabetes Institute

University Family Health Centers:
- North
- Northwest
- Southeast
- Southwest

University Health System Clinics:
- Eastside
- Good Health Clinic
- Kenwood
- Naco Perrin
- Old Hwy 90
- Salinas
- South Flores
- Westend
- Zarzamora

University Health System Business Center

MAGNET RECOGNITION
AMERICAN NURSES CREDENTIALING CENTER

THE JOINT COMMISSION
NATIONAL QUALITY APPROVAL

Report of Management Responsibility

The management of University Health System (the System) is responsible for the preparation and integrity of the financial information presented in this report. The basic financial statements have been prepared in accordance with accounting principles generally accepted in the United States as promulgated by the Governmental Accounting Standards Board, and include amounts based on judgments and estimates made by management. Management also prepares the management's discussion and analysis, discreetly presented component units, required supplementary information and other financial information included in the report and is responsible for its accuracy and consistency with the financial statements.

The basic financial statements have been audited by the independent accounting firm of BKD LLP, who was given unrestricted access to all financial records and related data, including the minutes of all meetings of the Board of Managers. Pursuant to the Bylaws, the Board of Managers provides oversight by reviewing and approving annual budgets; fiscal policies and procedures; and monthly financial statements. The Audit Committee reviews and recommends external auditors to the Board of Managers.

The System maintains a system of internal control over financial reporting, which is designed to provide reasonable assurance that transactions are executed as authorized and accurately recorded, that assets are properly safeguarded, and also provides reasonable assurance to our management and the Board of Managers regarding the reliability of our financial statements. The internal control system includes:

- A documented organizational structure and division of responsibility;
- Established policies and procedures which are routinely reviewed by management, regularly communicated to staff and that demand highly ethical conduct from all employees.

The System's Integrity Services Department monitors the operation of the internal control system and reports findings and recommendations to the management and the Board of Managers as appropriate. Corrective actions are taken to address control deficiencies and other opportunities for improvement as they are identified.

University Health System

George B. Hernandez, Jr.
President/Chief Executive Officer

Reed Hurley
Executive Vice President /
Chief Financial Officer

Bexar County Hospital District
d/b/a University Health System
A Component Unit of Bexar County, Texas
Balance Sheets
December 31, 2017 and 2016
(In Thousands)

Assets and Deferred Outflows of Resources	2017 System	2017 Component Unit Foundation	2017 Total	2016 System	2016 Component Unit Foundation	2016 Total
Current Assets						
Cash and cash equivalents	$ 86,513	$ 4,909	$ 91,422	$ 200,547	$ 6,944	$ 207,491
Short-term investments	365,119	2,524	367,643	215,543	-	215,543
Patient accounts receivable, net	122,843	-	122,843	95,798	-	95,798
Property taxes receivable, net	215,777	-	215,777	269,830	-	269,830
Estimated amounts due from third-party payers	76,047	-	76,047	67,633	-	67,633
Prepaid expenses and other current assets	83,236	387	83,623	49,462	305	49,767
Total current assets	949,535	7,820	957,355	898,813	7,249	906,062
Noncurrent Cash and Investments						
Noncurrent investments	45,280	-	45,280	27,957	-	27,957
Internally designated for capital acquisitions improvements	147,905	-	147,905	120,135	-	120,135
Internally designated for contingencies	255,216	-	255,216	223,048	-	223,048
Held by trustee for professional self-insurance	5,103	-	5,103	5,053	-	5,053
Held by trustee for capital acquisition and debt service	32,726	-	32,726	38,700	-	38,700
Total noncurrent cash and investments	486,230	-	486,230	414,893	-	414,893
Capital Assets, Net	1,169,022	-	1,169,022	1,199,289	-	1,199,289
Other Assets						
Long-term patient accounts receivable, net	4,929	-	4,929	10,053	-	10,053
Other	5,433	65	5,498	6,680	50	6,730
Total assets	2,615,149	7,885	2,623,034	2,529,728	7,299	2,537,027
Deferred Outflows of Resources						
Loss on bond refunding	14,374	-	14,374	15,144	-	15,144
Pensions	61,049	-	61,049	37,223	-	37,223
Total deferred outflows of resources	75,423	-	75,423	52,367	-	52,367
Total assets and deferred outflows of resources	$ 2,690,572	$ 7,885	$ 2,698,457	$ 2,582,095	$ 7,299	$ 2,589,394

Bexar County Hospital District
d/b/a University Health System
A Component Unit of Bexar County, Texas
Balance Sheets (Continued)
December 31, 2017 and 2016
(In Thousands)

Liabilities, Deferred Inflows of Resources and Net Position	2017			2016		
		Component Unit			Component Unit	
	System	Foundation	Total	System	Foundation	Total
Current Liabilities						
Current maturities of long-term debt	$ 17,975	$ -	$ 17,975	$ 30,265	$ -	$ 30,265
Accounts payable and accrued expenses	217,233	84	217,317	188,196	63	188,259
Medical claims payable	52,069	-	52,069	46,757	-	46,757
Revenue received in advance	6,027	-	6,027	5,277	-	5,277
Estimated amounts due to third-party payers	22,813	-	22,813	31,299	-	31,299
Total current liabilities	316,117	84	316,201	301,794	63	301,857
Estimated Self-insurance Costs	5,169	-	5,169	2,902	-	2,902
Net Pension Liability	166,683	-	166,683	139,998	-	139,998
Long-term Debt	652,107	-	652,107	673,505	-	673,505
Total liabilities	1,140,076	84	1,140,160	1,118,199	63	1,118,262
Deferred Inflows of Resources						
Property taxes	427,393	-	427,393	398,797	-	398,797
Pensions	3,591	-	3,591	-	-	-
Total deferred inflows of resources	430,984	-	430,984	398,797	-	398,797
Net Position						
Net investment in capital assets	507,471	-	507,471	502,112	-	502,112
Restricted - expendable	40,037	5,640	45,677	22,295	5,439	27,734
Restricted - non-expendable	-	330	330	-	323	323
Unrestricted	572,004	1,831	573,835	540,692	1,474	542,166
Total net position	1,119,512	7,801	1,127,313	1,065,099	7,236	1,072,335
Total liabilities, deferred inflows of resources and net position	$ 2,690,572	$ 7,885	$ 2,698,457	$ 2,582,095	$ 7,299	$ 2,589,394

Bexar County Hospital District
d/b/a University Health System
A Component Unit of Bexar County, Texas
Statements of Revenues, Expenses and Changes in Net Position
Years Ended December 31, 2017 and 2016
(In Thousands)

	2017			2016		
	System	Component Unit Foundation	Total	System	Component Unit Foundation	Total
Operating Revenues						
Net patient service revenue	$ 769,459	$ -	$ 769,459	$ 754,014	$ -	$ 754,014
Premium revenue	496,472	-	496,472	391,048	-	391,048
Other revenue	81,498	1,735	83,233	91,691	1,658	93,349
Total operating revenues	1,347,429	1,735	1,349,164	1,236,753	1,658	1,238,411
Operating Expenses						
Salaries and employee benefits	564,395	-	564,395	526,309	-	526,309
Medical claims expense	450,462	-	450,462	336,398	-	336,398
Purchased services	226,426	-	226,426	213,315	-	213,315
Medical services	138,390	-	138,390	124,054	-	124,054
Supplies and other	222,593	1,227	223,820	223,261	1,309	224,570
Depreciation	82,526	-	82,526	79,119	-	79,119
Total operating expenses	1,684,792	1,227	1,686,019	1,502,456	1,309	1,503,765
Operating Income (Loss)	(337,363)	508	(336,855)	(265,703)	349	(265,354)
Nonoperating Revenues (Expenses)						
Investment return	8,472	57	8,529	4,659	27	4,686
Interest expense	(32,347)	-	(32,347)	(35,987)	-	(35,987)
Debt issuance costs	-	-	-	(1,949)	-	(1,949)
Property tax revenue, net	399,652	-	399,652	366,930	-	366,930
Proceeds from tobacco settlement	7,773	-	7,773	5,580	-	5,580
Build America Bond interest subsidy	8,226	-	8,226	8,228	-	8,228
Total nonoperating revenues, net	391,776	57	391,833	347,461	27	347,488
Changes in Net Position	54,413	565	54,978	81,758	376	82,134
Net Position, Beginning of Year	1,065,099	7,236	1,072,335	983,341	6,860	990,201
Net Position, End of Year	$ 1,119,512	$ 7,801	$ 1,127,313	$ 1,065,099	$ 7,236	$ 1,072,335

Bexar County Hospital District
d/b/a University Health System
A Component Unit of Bexar County, Texas
Statements of Cash Flows
Years Ended December 31, 2017 and 2016
(In Thousands)

	2017	2016
Operating Activities		
Receipts from and on behalf of patients	$ 743,850	$ 793,615
Premiums collected, net of reinsurance	493,842	378,993
Payments to suppliers and contractors	(603,818)	(554,178)
Benefit and loss payments	(439,289)	(312,975)
Payments to or on behalf of employees	(553,289)	(514,274)
Other receipts, net	79,938	91,184
Net cash used in operating activities	(278,766)	(117,635)
Noncapital Financing Activities		
Receipt of property taxes supporting operations	412,367	271,263
Proceeds received from tobacco settlement	7,773	5,580
Net cash provided by noncapital financing activities	420,140	276,843
Capital and Related Financing Activities		
Receipt of property taxes for debt service	69,934	44,159
Principal paid on long-term debt	(30,265)	(24,271)
Interest paid on long-term debt	(34,800)	(38,321)
Receipt of Build America Bond interest subsidy	8,234	8,271
Purchase of capital assets	(55,834)	(75,134)
Proceeds from sale of capital assets	100	930
Net cash used in capital and related financing activities	(42,631)	(84,366)
Investing Activities		
Interest on investments	8,136	4,659
Purchase of investments	(801,273)	(749,821)
Proceeds from disposition of investments	580,360	584,566
Net cash used in investing activities	(212,777)	(160,596)
Decrease in Cash and Cash Equivalents	(114,034)	(85,754)
Cash and Cash Equivalents, Beginning of Year	200,547	286,301
Cash and Cash Equivalents, End of Year	$ 86,513	$ 200,547

Bexar County Hospital District
d/b/a University Health System
A Component Unit of Bexar County, Texas
Statements of Cash Flows (Continued)
Years Ended December 31, 2017 and 2016
(In Thousands)

	2017	2016
Reconciliation of Operating Loss to Net Cash Used in Operating Activities		
Operating loss	$ (337,363)	$ (265,703)
Depreciation	82,526	79,119
Provision for uncollectible accounts	151,458	136,751
Changes in operating assets and liabilities		
Patient accounts receivable, net	(175,961)	(147,394)
Estimated third-party payer settlements	(16,900)	32,768
Accounts payable and accrued expenses	40,341	39,480
Net pension liability	26,685	21,649
Deferred outflows of resources - pensions	(23,826)	(14,074)
Other assets, deferred outflows of resources, liabilities and deferred inflows of resources	(25,726)	(231)
Net cash used in operating activities	$ (278,766)	$ (117,635)
Noncash Investing, Capital and Financing Activities		
Capital asset acquisitions included in accounts payable and accrued expenses	$ 5,843	$ 9,018

In August 2016, the System advance refunded $215,485 of the Series 2008 Certificates with the issuance of the Limited Tax Refunding Bonds (the 2016 Bonds). Proceeds of $230,077 were deposited immediately for the defeasance of the outstanding bond principal and related accrued interest.

Bexar County Hospital District
d/b/a University Health System
A Component Unit of Bexar County, Texas
Pension Plan – Statements of Fiduciary Net Position
December 31, 2017 and 2016
(In Thousands)

	2017	2016
Assets		
Cash and cash equivalents	$ 2,370	$ 3,628
Receivables:		
Transfer receivable	-	727
Accrued income	20	19
Accrued employer contributions	365	321
Total receivables	385	1,067
Investments:		
Marketable securities:		
Common stocks	41,773	32,986
Mutual funds - common stocks	77,345	60,363
Mutual funds - fixed income securities	71,719	80,595
Pooled international equity fund	101,066	74,855
Total marketable securities	291,903	248,799
Alternative investments:		
Investment in Portfolio Advisors Private Equity Fund VI, VII and VIII L.P.	20,680	20,124
Investment in Crestline Offshore Fund, Ltd.	228	902
Investment in Private Advisors Stable Value ERISA Fund, LTD	1,604	5,034
Investment in Heitman Real Estate Trust	35,235	33,271
Investment in Standard Life Investments	15,326	-
Investment in Newton Investment Management	15,217	-
Total alternative investments	88,290	59,331
Total investments	380,193	308,130
Total assets	382,948	312,825
Liabilities		
Accounts payable and accrued expenses	248	214
Net position restricted for pension benefits	$ 382,700	$ 312,611

Bexar County Hospital District
d/b/a University Health System
A Component Unit of Bexar County, Texas
Pension Plan – Statements of Changes in Fiduciary Net Position
Years Ended December 31, 2017 and 2016
(In Thousands)

	2017	2016
Additions:		
Contributions:		
Plan member	$ 7,325	$ 6,589
Employer	25,804	19,289
	33,129	25,878
Net investment income:		
Interest income	79	48
Dividend income	5,309	5,275
Net appreciation in fair value of investments	50,475	17,885
Investment expenses	(866)	(670)
	54,997	22,538
Total additions	88,126	48,416
Deductions:		
Benefit payments	17,799	18,040
Administrative expenses	238	246
Total deductions	18,037	18,286
Change in net position restricted for pension benefits	70,089	30,130
Net position - beginning of year	312,611	282,481
Net position - end of year	$ 382,700	$ 312,611

Bexar County Hospital District
d/b/a University Health System
A Component Unit of Bexar County, Texas
Retiree Health Trust – Statements of Fiduciary Net Position
December 31, 2017 and 2016
(In Thousands)

	2017	2016
Assets		
Investments		
Wells Fargo Treasury Money Market	$ 917	$ 958
Vanguard Institutional Index Fund	35,238	28,933
Dodge & Cox Income Fund	4,592	4,400
Natixis Loomis Sayles Core Plus Bond	4,547	4,318
Total assets	45,294	38,609
Liabilities		
Accounts payable and accrued expenses	-	5
Net position restricted for other postemployment benefits	$ 45,294	$ 38,604

Bexar County Hospital District
d/b/a University Health System
A Component Unit of Bexar County, Texas
Retiree Health Trust – Statements of Changes in Fiduciary Net Position
Years Ended December 31, 2017 and 2016
(In Thousands)

	2017	2016
Additions:		
Contributions	$ 2,437	$ 4,094
Net investment income:		
Interest and dividend income	897	872
Net realized gains and appreciation in fair value of investments	5,837	2,751
Total additions	9,171	7,717
Deductions:		
Benefit payments	2,437	3,202
Administrative expenses	44	28
Total deductions	2,481	3,230
Change in net position restricted for other postemployment benefits	6,690	4,487
Net position - beginning of year	38,604	34,117
Net position - end of year	$ 45,294	$ 38,604

Note 1: Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations and Reporting Entity

The Bexar County Hospital District d/b/a University Health System (the System) is a hospital district established under Article IX, Section 4 of the Texas Constitution and Chapter 281 of the Texas Health and Safety Code. It is a political subdivision of the state of Texas, created to provide medical and hospital care to the needy and indigent of Bexar County, and is a discrete component unit of Bexar County (legally separate from Bexar County, Texas). Its Board of Managers (the Board) is composed of seven members appointed by the Commissioners Court of Bexar County for staggered terms of two years (or until a successor is appointed and qualified). Board members are "public officers" under the Texas Constitution who, as a body, exercise sovereign functions of government largely independent of the control of others, and serve without pay.

The System is one of the largest public health system in the state of Texas, with more than 7,000 employees and more than 800 physicians and resident physicians. It includes University Hospital, which operates an adult level 1 trauma center, the only level 1 pediatric trauma center in south Texas, the only Joint Commission-certified comprehensive stroke center in south Texas and the only level 4 comprehensive epilepsy center in south Texas. The System includes more than two dozen outpatient primary, specialty and preventive care centers, including the Robert B. Green Campus downtown; the Texas Diabetes Institute, dedicated to the prevention and treatment of diabetes; four family health centers; several neighborhood clinics, four dialysis centers; two outpatient surgery centers, two urgent care centers; two school-based health centers; and a healthcare program at Bexar County's correctional facilities. The System is the primary teaching partner of UT Health Science Center San Antonio d/b/a UT Health San Antonio (UT Health). The System is exempt from federal income tax under Section 115(a) of the Internal Revenue Code (IRC).

The System has established various affiliated nonprofit, tax-exempt organizations to facilitate the funding, delivery and management of its health care mission. The accompanying financial statements present the System and its component units, entities for which the System is considered to be financially accountable. Blended component units are, in substance, part of the primary government's operations, even though they are legally separate entities. Thus, blended units are appropriately presented as funds of the primary government. The System's discretely presented component unit is reported in a separate column in the financial statements to emphasize that it is legally separate from the government.

Blended component units. Community First Health Plans (CFHP), a not-for-profit corporation, was established in 1994 to assist the System with providing and arranging health care services in accordance with the *Texas Health Maintenance Organization Act* (Chapter 20A, Vernon's Texas Insurance Code). CFHP is organized as a health maintenance organization (HMO) licensed in Texas to provide comprehensive health care services to its members principally through its contractual relationships with physician groups, ancillary providers and hospitals, including the System. Because the System is the sole corporate member of CFHP, CFHP is reported as a blended component unit of the System. Separately issued financial reports are available for CFHP and may be obtained by contacting Community First Health Plans, 12238 Silicon Drive, Suite 100, San Antonio, Texas 78249.

University Medicine Associates (UMA) (formerly known as Community Medicine Associates) is a Texas nonprofit health organization certified by the Texas State Board of Medical Examiners pursuant to Section 501(a) of the Texas Medical Practice Act, now codified at Section 162.001 of the Texas Occupations Code. UMA provides primary care physician services at the System's University Family Health Centers. UMA is exempt from federal income tax under Section 501(c)(3) of the IRC. Because the System is the sole corporate member of UMA, UMA is presented as a blended component unit of the System. UMA does not issue separate financial statements.

Laundry Services of Texas, Inc. (LST) was formed to establish membership in Central Texas Laundry Linen, LLC (CTL). Owned by three regional health care organizations, CTL was formed to provide linen services to businesses and institutions in the region. LST holds a 24% interest in CTL, which is recorded using the equity method of accounting. The System's governing board is responsible for all financial decisions related to LST, there exists a financial benefit or burden relationship between the System and LST and the System's management has operational responsibility for LST. As such, the financial statements of LST are presented as a blended component unit of the System. LST does not issue separate financial statements. In June 2017, the legal name of LST was changed to University Health System Services of Texas, Inc.

Discretely presented component unit. University Health System Foundation (the Foundation) was created in 1984 to raise funds for the System. The Foundation is exempt from federal income tax under Section 501(c)(3) of the IRC and is a legally separate entity from the System. The Foundation is reported as a discretely presented component unit of the System since the Foundation's Board of Directors is appointed by the System's Board and the System can impose its will on the Foundation. The Foundation has no corporate member. Separately issued financial reports are available for the Foundation and may be obtained by contacting the System's administrative offices.

Pension and retiree health care trust funds. The University Health System Pension Plan (the Plan) is a single-employer defined benefit pension plan designated as a public retirement system as defined in and authorized by Section 810.001 of the Texas Government Code and a government plan within the meaning of the IRC Section 414(d). The Plan is administered by the System and is fiscally dependent on the System. The Plan is reported as a fiduciary fund in the funds statements. For purposes of measuring the net pension liability, deferred outflows of resources related to pensions, and pension expense, information about the fiduciary net position of the Plan and additions to/deductions from the Plan's fiduciary net position have been determined on the same basis as they are reported by the Plan. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value. Separate financial statements of the Plan are available at www.universityhealthsystem.com.

The University Health System Retiree Health Trust (the OPEB Trust) is a single-employer defined benefit OPEB established and administered by the System and is fiscally dependent on the System. The OPEB Trust is reported as a fiduciary fund in the funds statements. Separate financial statements of the OPEB Trust are available at the System's administrative offices.

Other significant relationships. In 1994, UT Health established a Texas nonprofit corporation organized under Section 501(a) of Article 4495b of the Texas Medical Practice Act, now codified at Section 162.001 of the Texas Occupations Code. This corporation serves as a contracting vehicle for physician services with the System and other payers, including managed care organizations.

Effective June 6, 2000, the System and Bexar County became the sole sponsors for the Center for Health Care Services (CHCS). The terms of the relationship are governed by a Sponsorship Agreement with Bexar County dated May 2, 2000. CHCS is a community center established under Chapter 534 of the Texas Health and Safety Code to provide a comprehensive array of mental health, mental retardation, and drug and alcohol abuse services throughout Bexar County. CHCS was originally established by a coalition of 17 local taxing authorities in 1966.

The Department of Aging and Disability Services (DADS) required CHCS to divest its dual roles as a local authority and provider of mental retardation services, which it did by transferring its responsibility for mental retardation authority to the Alamo Area Council of Governments (AACOG) effective September 1, 2006. The System entered into a memorandum of understanding with AACOG to connect the sponsorship obligations for mental retardation from CHCS to AACOG.

The balances and transactions of UT Medicine, CHCS and AACOG are not combined or otherwise included in the accompanying basic financial statements, but the System's transactions with these organizations are included.

Unless otherwise noted, the following notes do not include the Foundation, the Plan or the OPEB Trust and the values reported in the tables are in thousands.

Basis of Accounting and Presentation

The financial statements of the System have been prepared on the accrual basis of accounting using the economic resources measurement focus. Revenues, expenses, gains, losses, assets, liabilities and deferred inflows and outflows of resources from exchange and exchange-like transactions are recognized when the exchange transaction takes place, while those from nonexchange transactions (principally federal and state grants) are recognized when all applicable eligibility requirements are met. Operating revenues and expenses include exchange transactions and program-specific, government-mandated nonexchange transactions. Nonexchange transactions that are not program specific, property taxes, investment income and interest on capital assets-related debt are included in nonoperating revenues and expenses. The System first applies restricted net position when an expense or outlay is incurred for purposes for which both restricted and unrestricted net position are available.

In accordance with GASB Statement No. 34, the assets and net position of the Plan and the OPEB Trust are presented separately from those of the System. The Plan is used to account for assets held in trust for the benefit of the employees of the System for the defined benefit pension plan. The OPEB Trust is used to account for assets held in trust related to the postretirement benefit program for employees of the System. The financial statements of the Plan and the OPEB Trust are prepared using the accrual basis of accounting.

Employer contributions to the Plan and the OPEB Trust are recognized when due. Benefits are recognized when due and payable in accordance with the terms of the Plan and OPEB Trust.

Use of Estimates

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

Cash and Cash Equivalents

The System considers all liquid investments with original maturities of three months or less to be cash equivalents. At December 31, 2017 and 2016, cash and cash equivalents include demand deposits and money market mutual funds. The System does not consider highly liquid investments that are designated as to use as cash equivalents.

Patient Accounts Receivable

The System reports patient accounts receivable for services rendered at net realizable amounts from third-party payers, patients and others. The System provides an allowance for uncollectible accounts based upon a review of outstanding receivables, historical collection information and existing economic conditions.

Supplies

Supply inventories are stated at the lower of cost, determined using the first-in, first-out method, or market.

Investments and Investment Income

Investments in U.S. Treasury, agency and instrumentality obligations with a remaining maturity of one year or less at time of acquisition and in non-negotiable certificates of deposit are carried at amortized cost. Investments in external investment pools qualifying for amortized cost under GASB Statement No. 79, *Certain External Investment Pools and Pool Participants*, are carried at amortized cost per share. All other investments are carried at fair value as determined using quoted market prices.

Investment income includes dividend and interest income, realized gains and losses on investments carried at other than fair value and the net change for the year in the fair value of investments carried at fair value.

State statutes and the Board of Managers authorize the System to invest in a limited number of instruments, as further described in *Note 3*.

Capital Assets

Capital assets are recorded at cost at the date of acquisition, or acquisition value at the date of donation if acquired by gift. Depreciation is computed using the straight-line method over the estimated useful life of each asset. Assets under capital lease obligations and leasehold improvements are depreciated over the shorter of the lease term or their respective estimated useful lives. The following estimated useful lives are being used by the System:

Land improvements	5 – 15 years
Buildings and leasehold improvements	10 – 30 years
Equipment	5 – 15 years

Compensated Absences

The System's employees earn paid time off (PTO) at varying rates depending on years of service. Employees may accumulate PTO up to a specified maximum. Employees are paid for accumulated PTO upon voluntary termination, including retirement, as employees who retire from the System may convert accumulated PTO to termination payments at a rate of 50% of their accumulated PTO balances. The estimated amount of PTO payable as termination payments is reported as a current liability in both 2017 and 2016.

Deferred Outflows/Inflows of Resources

Transactions not meeting the definition of an asset or liability that result in the consumption or acquisition of net position in one period that are applicable to future periods are reported as deferred outflows of resources or deferred inflows of resources in a separate section of its balance sheets.

Net Position

Net position of the System is classified in four components. Net investment in capital assets consists of capital assets net of accumulated depreciation and reduced by the outstanding balances of borrowings used to finance the purchase or construction of those assets. Restricted expendable net position is made up of noncapital assets that must be used for a particular purpose, as specified by enabling legislation, creditors, grantors or donors external to the System, including amounts deposited with trustees as required by bond indentures, reduced by the outstanding balances of any related borrowings. Restricted nonexpendable net position consists of noncapital assets that are required to be maintained in perpetuity as specified by parties external to the System, such as permanent endowments. Unrestricted net position is the remaining net position that does not meet the definition of net investment in capital assets or restricted net position.

Risk Management

The System is exposed to various risks of loss from torts; theft of, damage to and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; natural disasters; medical malpractice; and employee health, dental and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters other than medical malpractice, employee health and workers' compensation claims. Settled claims have not exceeded this commercial coverage in any of the three preceding years.

The System is self-insured for a portion of its exposure to risk of loss from medical malpractice, employee health and workers' compensation claims. Annual estimated provisions are accrued for the self-insured portion of these risks and include an estimate of the ultimate costs for both reported claims and claims incurred but not yet reported.

Net Patient Service Revenue

The System has agreements with third-party payers that provide for payments to the System at amounts different from its established rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers and others for services rendered and includes estimated retroactive revenue adjustments and a provision for uncollectible accounts. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered and such estimated amounts are revised in future periods as adjustments become known.

Charity Care

The System provides charity care to residents of Bexar County who qualify on a financial basis for the Care*Link* Program and to all others who qualify based on the System's charity care policy. The System does not pursue collection of amounts in excess of the established guidelines for those patients who meet the charity criteria. Such excess is considered charity care and is not reported as revenue.

The System's Care*Link* Program is used to discount gross charges for medical services received in the System's facilities. Under this program, residents of Bexar County have an established maximum family liability rather than a discount of total gross charges. Key factors in establishing a family's maximum liability levels are: number of dependents, income and the relationship of these factors to the current Poverty Index. The System does not pursue collection of amounts in excess of the maximum family liability. Such excess amounts are considered charity care and are not reported as revenue.

Arrangements are made with residents of Bexar County to pay their reduced medical costs in installments. Any amounts designated as not being due prior to December 31 of the subsequent year are classified as long-term patient receivables and are presented net of applicable allowances.

Non-Care*Link* patients meeting the financial and medical indigency criteria established in the charity policy receive a discount from gross charges for emergency and catastrophic medical services received in the System's facilities. Charges for financial indigency are discounted based on family income compared to the Poverty Index. Charges for medical indigency are discounted when charges exceed a certain income and asset level.

The System maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges forgone for services and supplies furnished under its charity care policy. The charges forgone, based on established rates, were approximately $568,930 and $520,139 for the years ended December 31, 2017 and 2016, respectively. The costs of charity care provided under the System's charity care policy were approximately $174,048 and $162,750 for 2017 and 2016, respectively. The cost of charity care is estimated by applying the ratio of cost to gross charges to the gross charity care charges.

Premium Revenue

CFHP has agreements with plan sponsors to arrange health service benefits for subscribing participants. Under these agreements, CFHP receives monthly premium payments based on the number of each plan sponsor's participants. In addition, CFHP receives supplementary delivery payments under the Medicaid program.

Medical Claims Expense

CFHP arranges for the provision of comprehensive health care services to its members principally through its contractual relationships with physician groups, ancillary providers, and hospitals, including the System. Physicians, ancillary providers, and hospitals are paid a contracted fee for service or a capitation rate, and CFHP is responsible for any related payments to those providers.

The cost of health care services provided is accrued in the period it is rendered to the enrolled members, based in part on estimates for hospital and physician services rendered to enrolled members during the period that have not yet been reported.

Premium Deficiency Reserve

Premium deficiency losses are recognized when it is probable that expected claims expense will exceed future premiums on existing insurance contracts. CFHP does not include investment income in the premium deficiency reserve calculation. CFHP recorded a $6,050 premium deficiency reserve at December 31, 2017. CFHP did not have a premium deficiency reserve at December 31, 2016.

Reserves for Incurred But Not Reported Medical Claims

CFHP's management estimates and provides reserves for incurred but not reported physician and hospital services rendered to enrolled members during the period. These reserves represent management's best estimate of the ultimate net cost of all reported and unreported claims incurred during the reporting period. The estimate is based on actuarial projections of the historical development of claims incurred but not reported and case-basis estimates of claims reported prior to the end of the reporting period.

The estimate of the unpaid claims liability is based on the best data available to management; however, the estimates are subject to a significant degree of inherent variability. The estimates are continually reviewed and adjusted as necessary as experience develops or new information becomes known; such adjustments are included in current operations.

(In Thousands)

Although management believes the estimate of the unpaid liability is reasonable, it is possible that actual incurred claims expense will not conform to the assumptions inherent in the determination of the liability; accordingly, the ultimate settlement of the claims may vary significantly from the estimate included in the accompanying financial statements.

Tobacco Settlement Revenue

Tobacco settlement revenue is the result of a settlement between various counties and hospital districts in Texas and the tobacco industry for tobacco-related health care costs. The System received approximately $7,773 and $5,580 in revenue from this settlement for the years ended December 31, 2017 and 2016, respectively. This revenue is recognized as nonoperating revenue in the accompanying statements of revenues, expenses and changes in net position.

Property Taxes

The System received approximately 23% of its financial support from property taxes in both 2017 and 2016. These funds were used as follows:

	2017	2016
Percentage used to support operations	85.5%	86.0%
Percentage used for debt service on bonds	14.5%	14.0%
Total	100.0%	100.0%

Property taxes are levied by the System on October 1 of each year based on the preceding January 1 assessed property values. To secure payment, an enforceable lien attaches to the property on January 1, when the value is assessed. Property taxes become due and payable when levied on October 1. This is the date on which an enforceable legal claim arises and the System records a receivable for the property tax assessment, less an allowance for uncollectible taxes. Property taxes are considered delinquent after January 31 of the following year. The System recorded an allowance for uncollectible property taxes of approximately $16,314 and $16,168 at December 31, 2017 and 2016, respectively.

At December 31, 2017 and 2016, respectively, the System had recorded approximately $427,393 and $398,797 of property taxes levied for services to be provided in 2018 and 2017, respectively. These amounts are reported as a deferred inflow of resources in the accompanying balance sheets and will be recognized as revenue in the period for which they were levied.

The System’s property tax rate was $0.236069 and $0.237609 per $100 valuation for both 2017 and 2016 for the maintenance and operation fund. The System’s property tax rate was $0.040166 and $0.038626 per $100 valuation for 2017 and 2016, respectively, for the interest and sinking fund.

Build America Bond Interest Subsidy

The System issued taxable Build America Bonds (BABs) in August 2010 and August 2009. Under the BABs program, the U.S. Treasury pays 35% of the interest as a subsidy to the issuer. The System records the interest subsidy received or receivable from the U.S. Treasury as nonoperating revenue when the System has met all of the eligibility criteria to receive the subsidy. The System recorded $8,226 and $8,228 of nonoperating revenue in 2017 and 2016, respectively, for the BABs interest subsidy. During 2017 and 2016, the BABs subsidy was 6.9% and 6.8%, respectively.

Income Taxes

As an essential government function of the County, the System is generally exempt from federal and state income taxes under Section 115 of the IRC and a similar provision of state law. UMA, CFHP and the Foundation carry exemptions from income taxes under IRC Section 501 sections. UMA, CFHP and the Foundation are subject to federal income tax on any unrelated business taxable income.

The System has applied to be recognized as exempt from income taxes under Section 501(c)(3) of the IRC and a similar provision of state law. The Internal Revenue Service is reviewing the System's application and has not yet granted 501(c)(3) status. If approved, the System would be subject to federal income tax on any unrelated business taxable income retroactive to the date the System applied to be recognized as exempt from income taxes under Section 501(c)(3).

Reclassifications

Certain reclassifications have been made to the 2016 financial statements to conform to the 2017 financial statement presentation. These reclassifications had no effect on the change in net position.

Note 2: Net Patient Service Revenue

The System has agreements with third-party payers that provide for payments to the System at amounts different from its established rates. These payment arrangements include:

Medicare. Inpatient acute care services and substantially all outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. Certain inpatient nonacute services and defined medical education costs are paid based on a cost reimbursement methodology.

The System is reimbursed for certain services at tentative rates with final settlement determined after submission of annual cost reports by the System and audits thereof by the

Medicare fiscal intermediary. The System's Medicare cost reports have been audited by the Medicare administrative contractor through December 31, 2013.

Medicaid. Inpatient services rendered to Medicaid program beneficiaries are reimbursed under a prospective payment system. Inpatient reimbursement is inclusive of an add-on for trauma care that is based on the Medicaid Standard Dollar Amount. Outpatient and physician services are reimbursed under a mixture of fee schedules and cost reimbursement. The System is reimbursed for cost reimbursable services at tentative rates with final settlement determined after submission of annual cost reports by the System and audits thereof by the Medicaid administrative contractor. The System's Medicaid cost reports have been audited by the Medicaid administrative contractor through December 31, 2013.

Approximately 65% of net patient service revenue is from participation in the Medicare and state-sponsored Medicaid programs for the years ended December 31, 2017 and 2016. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation and change. As a result, it is reasonably possible that recorded estimates will change materially in the near term.

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 prospectively determined daily rates.

Supplemental Medicaid Funding Revenue

In response to the growing number of uninsured patients and the rising cost of health care, the Texas Legislature established a Texas Medicaid Disproportionate Share Program (DSH Program) that was designed to assist those facilities serving the majority of the indigent patients by providing funds supporting increased access to health care within the community. This program allows the Texas Department of Human Services to levy assessments from certain hospitals, use the assessed funds to obtain federal matching funds, and then redistribute the total funds to those facilities serving a disproportionate share of indigent patients in the state of Texas. At December 31, 2017 and 2016, respectively, the System had recorded approximately $6,027 and $5,277 of DSH revenue for services to be provided in 2018 and 2017, respectively. These amounts are reported as revenue received in advance in the accompanying balance sheets and are recognized as revenue during the period in which services are provided.

On December 12, 2011, the United States Department of Health and Human Services (HHSC) approved a Medicaid section 1115(a) demonstration entitled "Texas Health Transformation and Quality Improvement Program" (the Waiver) that allowed the state to expand Medicaid managed care while preserving hospital funding, provides incentive payments for health care improvements and directs more funding to hospitals that serve large numbers of uninsured patients. The Waiver established two pools, an Uncompensated Care Pool (UC Pool) to offset the cost of uncompensated care and a Delivery System Reform Initiative Payment Pool (DSRIP) as incentive payments for developing programs and strategies supporting hospitals' efforts to improve access to health care; improve quality and outcomes of care, improve efficiencies of care provided; and to improve the patient experience by managing the health of patients and families served. DSRIP payments are made for system improvements identified in Regional Healthcare Partnerships (RHP) delivery system reform and improvement plans (RHP Plan) led by public hospitals such as the System or governmental entities that will provide the state share of Waiver pool funds. The System serves as the anchor facility for the 20 county RHP 6. The revenue from the two funding pools is recognized as earned throughout the related demonstration year. Funding from the UC Pool is limited to actual uncompensated care costs, as defined by the Waiver. The System has recorded an estimated liability for payments received in excess of its cost.

The Waiver was originally effective from December 12, 2011 to September 30, 2016 and extended through December 2017 as HHSC and the Centers for Medicare and Medicaid Services (CMS) negotiated a longer term extension. On December 21, 2017, HHSC received an approved extension from CMS for the period of January 1, 2018 through September 30, 2022. Among other changes, the approved plan limits UC Pool funding to the cost of providing charity care and requires a phase out of DSRIP over the five year period. The impact of these changes has not yet been determined, but could have an adverse impact on the System's operating results.

The System participates in the Network Access Improvement Program (NAIP). The NAIP aims to increase the availability and effectiveness of primary care for Medicaid beneficiaries by providing incentive payments to participating Health Related Institutions (HRIs). Participation is voluntary and requires HRIs to create a proposal in partnership with a managed care organization (MCO). When the proposal is approved by the Health and Human Services Commission, the costs associated with the incentive payments are added to the monthly capitation rates paid to the MCO and the MCOs are responsible for making payments to the HRIs, such as the System.

During 2017, the System began to participate in the Uniform Hospital Rate Increase Program (UHRIP). Under UHRIP, HHSC may direct managed care organizations in a service delivery area to provide a uniform percentage rate increase to all hospitals within a particular class of hospitals. Revenues from UHRIP were not significant in 2017. In 2017, the System made advance intergovernmental transfers for UHRIP of $24,177 that has been recognized as a prepaid expense in the balance sheet.

Through August 2016, the System also participated in the state of Texas Minimum Payment Amounts to Qualified Nursing Facilities Program (MPAP). Under this program, supplemental funds could be obtained to offset a portion of the difference between the Medicare and Medicaid rates for nursing facility services. In September 2016, the MPAP ended and the System began participating the in the Quality Improvement Payment Program (QIPP). QIPP is designed to assist nursing facilities serving indigent patients by providing funding to support increased access to health care into the community. It is also designed to allow participating providers to receive additional reimbursement if they either reach a national benchmark level or they make quarterly improvements in up to four predetermined quality measures.

(In Thousands)

Revenue recognized from all programs is included as a component of net patient service revenue in the statements of revenues, expenses and changes in net position as follows:

	2017	2016
DSH Program	$ 32,104	$ 28,682
UC Pool	46,633	54,552
DSRIP	55,270	60,120
NAIP	30,716	44,195
MPAP/QIPP	486	3,095
	$ 165,209	$ 190,645

Accounts receivable under these programs were $76,047 and $67,633 at December 31, 2017 and 2016, respectively, and are included in estimated amounts due from third-party payers.

The System realized a savings in medical service costs of $96,221 and $107,400 in 2017 and 2016, respectively. The System incurred increased costs to supplement the state's funding for the affiliated providers by approximately $74,971 and $82,187 in 2017 and 2016, respectively. The supplement to the state's funding is recorded in medical services expense in the statements of revenues, expenses and changes in net position.

The programs described above are subject to review and scrutiny by both the Texas Legislature and the CMS and the programs could be modified or terminated based on new legislation or regulation in future periods.

Note 3: Deposits and Investments

Deposits

Custodial credit risk is the risk that in the event of a bank failure, a government's deposits may not be returned to it. The System's deposit policy for custodial credit risk requires compliance with the provisions of state law.

State law requires collateralization of all deposits with federal depository insurance or other qualified investments. At December 31, 2017, the System had $732 of cash that was uninsured and uncollateralized. At December 31, 2016, the System had $4,767 of cash that was uninsured and uncollateralized.

(In Thousands)

Investments

The System may legally invest in direct obligations of and other obligations guaranteed as to principal by the U.S. Treasury and U.S. agencies and instrumentalities and in bank repurchase agreements. It may also invest to a limited extent in corporate bonds and equity securities.

At December 31, 2017 and 2016, the System had the following investments and maturities:

	December 31, 2017				
		Maturities in Years			
Type	Fair Value	Less than 1	1-5	6-10	More than 10
U.S. Treasury obligations	$ 42,461	$ 34,373	$ 8,088	$ -	$ -
U.S. agencies obligations	276,846	152,245	124,532	69	-
Municipal bonds	4,270	4,270	-	-	-
Commercial paper	217,594	217,594	-	-	-
Money market mutual funds	156,433	156,433	-	-	-
Investment pool	250,714	250,714	-	-	-
	$ 948,318	$ 815,629	$ 132,620	$ 69	$ -

	December 31, 2016				
		Maturities in Years			
Type	Fair Value	Less than 1	1-5	6-10	More than 10
U.S. Treasury obligations	$ 13,347	$ 9,620	$ 3,727	$ -	$ -
U.S. agencies obligations	278,144	142,219	135,925	-	-
Municipal bonds	4,354	-	4,354	-	-
Commercial paper	99,392	99,392	-	-	-
Money market mutual funds	217,133	217,133	-	-	-
Corporate bonds	5,151	5,151	-	-	-
Investment pool	196,325	196,325	-	-	-
	$ 813,846	$ 669,840	$ 144,006	$ -	$ -

Interest Rate Risk – As a means of limiting its exposure to fair value losses arising from rising interest rates, the System's investment policy requires that total investments have a weighted-average maturity of five years or less. The longer the maturity of a fixed-rate obligation, the greater the impact a change in interest rates will have on its fair value. As interest rates increase, the fair value of the obligations decrease. Likewise, when interest rates decrease, the fair value of the obligations increase. The money market mutual funds are presented as an investment with a maturity of less than one-year because they are redeemable in full immediately. The System's investment policy limits the maturity periods of its investments by type to a maximum of 10 years.

Credit Risk – Credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization (NRSRO). The System and CFHP each have formal investment policies adopted by the Board of Managers and Board of Directors, respectively, that limit investments in securities based on an NRSRO credit rating. The System's investments are also subject to the *Public Funds Investment Act* (the Act), at Government Code Chapter 2256, and CFHP's investments are also subject to regulations enumerated in Title 28, Chapter 11 of the Texas Administrative Code (TAC) and Chapter 20A of the Texas Insurance Code (TIC).

Investments authorized by the Act and the System's investment policy are limited to: obligations of the United States government or its agencies; repurchase agreements collateralized by obligations of the United States government or its agencies; investment pools with at least an AA-m or better rating by one nationally recognized rating service; commercial paper with a stated maturity of 270 days or less, and a credit rating of A-1 or P-1 or its equivalent by at least two nationally recognized credit rating agencies; certificates of deposit issued by a state bank, national bank, or a savings and loan association domiciled in Texas, with FDIC insurance and collateralized by obligations of the U.S. government or its agencies, with market value of 102% of the insured principal amount; bankers' acceptances of a bank organized and existing under the laws of the United States, whose short-term obligations are rated not less than A-1 or P-1 or its equivalent by at least one nationally recognized rating agency, and with a stated maturity of 270 days or less; and no-load money market mutual funds registered by the Securities and Exchange Commission with a dollar-weighted-average stated maturity of 90 days or less, and an investment objective of a stable net asset value of one dollar.

Investments authorized by the TAC, TIC and CFHP's investment policy are limited to obligations of the United States government or its agencies; certificates of deposit with a credit rating of Moody's A2 or Standard & Poor's (S&P) A; corporate obligations with a credit rating of Moody's A1 or S&P A+; municipal notes and bonds with a credit rating of Moody's Aaa or S&P AAA; auction-rate securities with a credit rating of Moody's A2 or S&P A; and asset-backed securities with a credit rating of Moody's Aaa or S&P AAA.

The System's investments in U.S. Treasury obligations carry the explicit guarantee of the U.S. government. At December 31, 2017, the debt securities of the U.S. agencies are rated A1+ or AA+ by S&P or Aaa by Moody's. The System's investments in municipal bonds were rated AA to AAA by S&P at December 31, 2017. The System's investments in commercial paper was rated A- to AA- by S&P at December 31, 2017.

The System also invests in TexPool, a state investment pool, which is considered an investment for financial reporting. The Texas State Comptroller of Public Accounts (Comptroller) oversees TexPool. Federated Investors provides asset management and participant services for TexPool's operations under a contract with the Comptroller. The Comptroller has established an advisory board composted of participants and others who do not have a business relationship with TexPool. The advisory board reviews the investment policy and management fee structure. TexPool is not registered with the Securities and Exchange Commission as an investment company. The District has an undivided beneficial interest in the pool of assets held by TexPool. Investments must be in compliance with the *Texas Public Fund Investment Act* and include obligations of the United States or its agencies, direct obligation of the state of Texas or its agencies, certificates of deposit and repurchase agreements. The fair value of the position in these pools is the same as the value of the shares in each pool. TexPool is rated AAAm by Standard & Poor's.

Custodial Credit Risk – For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the System will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. All of the System's investments are held in safekeeping or trust accounts.

Concentration of Credit Risk – The System places no limit on the amount that may be invested in any one issuer as long as the restrictions of the *Texas Public Funds Investment Act* are followed.

The following table reflects the System and CFHP's investments in single issuers that represent more than 5% of total investments:

	2017	2016
Federal National Mortgage Association	4%	7%
Federal Home Loan Mortgage Corporation	10%	7%
Federal Home Loan Bank	11%	9%
Federal Farm Credit Bank	4%	9%

(In Thousands)

Summary of Carrying Values

The carrying values of deposits and investments shown above are included in the System's balance sheets as follows:

	2017	2016
Carrying value		
Deposits	$ (10,456)	$ 17,137
Investments	948,318	813,846
	$ 937,862	$ 830,983
Included in the following balance sheet captions		
Cash and cash equivalents	$ 86,513	$ 200,547
Short-term investments	365,119	215,543
Noncurrent cash and investments	486,230	414,893
	$ 937,862	$ 830,983

The System's outstanding checks in excess of deposit balances are covered by money market mutual funds held with the right of offset at the same financial institution.

Note 4: Patient Accounts Receivable

The System grants credit without collateral to its patients, many of whom are area residents and are insured under third-party payer agreements. Patient accounts receivable at December 31 consisted of:

	2017	2016
Medicare	$ 36,164	$ 35,826
Medicaid	35,785	35,451
Other third-party payers	52,992	52,497
Patients	458,778	454,495
	583,719	578,269
Less allowance for uncollectible accounts	455,947	472,418
	$ 127,772	$ 105,851

(In Thousands)

Note 5: Capital Assets

The System's capital assets activity for the years ended December 31 was:

	2017			
	Beginning Balance	Additions/ Transfers	Disposals/ Other	Ending Balance
Land and land improvements	$ 20,864	$ 42	$ -	$ 20,906
Buildings and improvements	1,337,686	30,689	-	1,368,375
Equipment	413,108	45,555	(7,050)	451,613
Construction in progress	29,610	(23,627)	-	5,983
	1,801,268	52,659	(7,050)	1,846,877
Less accumulated depreciation	601,979	82,526	(6,650)	677,855
Capital assets, net	$ 1,199,289	$ (29,867)	$ (400)	$ 1,169,022

	2016			
	Beginning Balance	Additions/ Transfers	Disposals/ Other	Ending Balance
Land and land improvements	$ 19,449	$ 1,415	$ -	$ 20,864
Buildings and improvements	1,299,977	37,709	-	1,337,686
Equipment	390,101	26,956	(3,949)	413,108
Construction in progress	17,237	12,373	-	29,610
	1,726,764	78,453	(3,949)	1,801,268
Less accumulated depreciation	526,508	79,119	(3,648)	601,979
Capital assets, net	$ 1,200,256	$ (666)	$ (301)	$ 1,199,289

(In Thousands)

Note 6: Accounts Payable and Accrued Expenses

The System's accounts payable and accrued expenses included in current liabilities at December 31 consisted of:

	2017	2016
Payable to suppliers and contractors	$ 143,657	$ 127,162
Payable to employees (including payroll taxes and benefits)	42,048	38,242
Accrued interest	13,587	13,386
Premium deficiency reserve	6,051	-
Estimated self-insurance costs - current	3,982	5,400
Other accrued liabilities	7,908	4,006
	$ 217,233	$ 188,196

Note 7: Risk Management

Employee Health Claims

The System is self-insured for employee health insurance costs. The self-insured plan is administered by CFHP, which determines the cost of claims paid to community health care providers and estimates a reserve for medical claims incurred but not yet reported. The System also recognizes the incremental cost of services provided by the System to plan participants. The System maintains a stop-loss insurance contract to cover 90% of certain medical costs in excess of $175 per claim, up to a maximum of $2,000 per contract year and $5,000 per member lifetime maximum.

Workers' Compensation Claims

The System participates in a self-insurance program that provides for the payment of workers' compensation claims. The funding for this program is based on third-party recommendations for settlement in accordance with Texas workers' compensation laws. The System has purchased reinsurance for individual claims exceeding $600 up to a maximum limit of $1,000 for any one accident or occurrence.

(In Thousands)

Professional Liability Claims

The System funds a revocable self-insurance trust to provide for the payment of medical malpractice liabilities. The funding is based on management's recommendations for settlement of claims to limits of $100 per claim and $300 per occurrence, in accordance with the limited liability provisions of the Texas Tort Claims Act. The System is also self-insured for "tail coverage" for certain employed physicians. This coverage has a limited time exposure and also is subject to claims limits. Amounts are provided for funding, and estimated liabilities for incurred but not yet reported claims are based on management estimates.

Losses from asserted and unasserted claims identified under the System's incident reporting system are accrued based on estimates that incorporate the System's past experience, as well as other considerations, including the nature of each claim or incident and relevant trend factors. It is reasonably possible that the System's estimate of losses will change by a material amount in the near term.

Changes in and the balances of the System's aggregate claims liability in fiscal years 2017 and 2016 are as follows:

	Beginning of Fiscal Year Liability	Current-Year Expenses	Claim Payments	Balance at Fiscal Year-End
Employee health claims				
2017	$ 2,100	$ 22,021	$ (22,039)	$ 2,082
2016	1,586	21,355	(20,841)	2,100
Workers' compensation claims				
2017	$ 5,002	$ 2,586	$ (1,719)	$ 5,869
2016	4,860	$ 2,460	(2,318)	5,002
Professional liability				
2017	$ 1,200	$ 44	$ (44)	$ 1,200
2016	1,048	272	(120)	1,200

(In Thousands)

Medical Claims Payable

CFHP's medical claims payable represents the estimate of the ultimate net cost of all reported and unreported medical claims incurred but not paid through the end of the year. This estimate is based on claims reported, actuarial estimates and trends in the health care costs. Subsequent actual claims experience and related settlement costs may differ from the estimated liability due to variances in estimated and actual subscriber utilization of medical services, the amount of charges and other factors. This estimate is subject to a significant degree of inherent variability. The estimates are continually reviewed and any necessary adjustments are included in current operations.

Changes in and the balances of CFHP's aggregate medical claims liability in 2017 and 2016 are as follows:

	2017	2016
Medical claims payable, beginning of year	$ 46,757	$ 23,685
Incurred related to		
Current year	452,923	339,029
Prior years	(8,511)	(2,631)
Total incurred losses and claims payable	444,412	336,398
Paid related to		
Current year	400,857	292,324
Prior years	38,243	21,002
Total paid losses and claims payable	439,100	313,326
Medical claims payable, end of year	$ 52,069	$ 46,757

Patient service revenue and medical claims expense for CFHP members amounting to $22,218 and $27,234 in 2017 and 2016, respectively, are not eliminated in the basic financial statements.

(In Thousands)

Note 8: Long-term Debt

A summary of long-term debt is as follows:

	2017	2016
Certificates of Obligation, Series 2008	$ 24,705	$ 30,720
Certificates of Obligation, Series 2009A	-	6,745
Certificates of Obligation, Series 2009B	246,395	246,395
Certificates of Obligation, Series 2010B	177,600	181,275
Certificates of Obligation, Series 2015	-	9,850
Limited Tax Refunding Bonds, Series 2016	195,260	199,240
	643,960	674,225
Bond premium (discount), net	26,122	29,545
	$ 670,082	$ 703,770

Certificates of Obligation – Series 2008

The combination tax and revenue Certificates of Obligation, Series 2008 (the 2008 Certificates) were issued in 2008, and mature in various amounts annually on February 15, from 2009 through 2038. These have stated coupon rates ranging from 3.25% to 5.00%, and are collateralized by a levy of ad valorem tax revenue and lien on and pledge of surplus revenues. In February 2018, the System elected to exercise the option to redeem all of the 2008 Certificates still outstanding at a price of par plus accrued interest at the date of redemption.

In August 2016, the System advance refunded $215,485 of the Series 2008 Certificates with the issuance of the Limited Tax Refunding Bonds (the 2016 Bonds). As a result of the refunding, the System decreased its total debt service requirements by $69,350 and incurred an accounting loss of approximately $15,155. The accounting loss on the refunding is being amortized into interest expense using a straight-line method over the term of the 2016 Bonds, which mature in 2037. The balance of the deferred loss on the refunding is $14,374, and $15,144 at December 31, 2017 and 2016, respectively, and is included as a deferred outflow of resources in the accompanying balance sheets.

Certificates of Obligation – Series 2009A and 2009B

The tax Certificates of Obligation, Series 2009A (the 2009A Certificates) were issued in 2009, and matured in various amounts annually on February 15, from 2010 through 2017, with stated coupon rates ranging from 1.00% to 5.00%. The Series 2009A Certificates were paid in full during 2017. The tax Certificates of Obligation, Series 2009B (the 2009B Certificates) were issued in 2009, and mature in various amounts annually on February 15, from 2018 through 2039, with stated coupon rates ranging from 5.269% to 6.904%. The 2009B Certificates are collateralized by a levy of ad valorem tax revenue. All of the 2009B Certificates with stated maturities on or after February 15, 2020 may be redeemed at the System's option on or after February 15, 2019 at a price of par plus accrued interest at the date of redemption.

Certificates of Obligation – Series 2010B

The tax Certificates of Obligation, Series 2010B (the 2010B Certificates) were issued in 2010, and mature in various amounts annually on February 15, from 2011 through 2040, with stated coupon rates ranging from 0.300% to 5.413% and are collateralized by a levy of ad valorem tax revenue.

The 2009B Certificates and 2010B Certificates are designated under the *American Recovery and Reinvestment Act of 2009* as "Qualified Build America Bonds" debt.

Certificates of Obligation – Series 2015

The combination tax and revenue Certificates of Obligation, Series 2015 (the 2015 Certificates) were issued in 2015. Prior to being paid in full in 2017, the 2015 Certificates matured in various amounts annually through February 15, 2017, with a stated coupon rate of 0.750%. The 2015 Certificates were collateralized by a levy of ad valorem tax revenue and lien on and pledge of surplus revenues.

Limited Tax Refunding Bonds – Series 2016

The 2016 Bonds were issued in 2016, and mature in various amounts annually on February 15, from 2017 through 2037, with stated coupon rates ranging from 1.5% to 5.0% and are collateralized by a levy of ad valorem tax revenue and lien on and pledge of surplus revenues. All of the 2016 Bonds still outstanding may be redeemed at the System's option on or after February 15, 2026 at a price of par plus accrued interest at the date of redemption.

(In Thousands)

The following is a summary of long-term debt transactions for the System for the years ended December 31:

	2017				
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Long-term debt					
Certificates of Obligation, Series 2008	$ 30,720	$ -	$ (6,015)	$ 24,705	$ 6,720
Certificates of Obligation, Series 2009A	6,745	-	(6,745)	-	-
Certificates of Obligation, Series 2009B	246,395	-	-	246,395	7,005
Certificates of Obligation, Series 2010B	181,275	-	(3,675)	177,600	4,250
Certificates of Obligation, Series 2015	9,850	-	(9,850)	-	-
Limited Tax Refunding Bonds, Series 2016	199,240	-	(3,980)	195,260	-
Total long-term debt	$ 674,225	$ -	$ (30,265)	$ 643,960	$ 17,975

	2016				
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Long-term debt					
Certificates of Obligation, Series 2008	$ 251,960	$ -	$ (221,240)	$ 30,720	$ 6,015
Certificates of Obligation, Series 2009A	13,195	-	(6,450)	6,745	6,745
Certificates of Obligation, Series 2009B	246,395	-	-	246,395	-
Certificates of Obligation, Series 2010B	184,010	-	(2,735)	181,275	3,675
Certificates of Obligation, Series 2015	18,500	-	(8,650)	9,850	9,850
Limited Tax Refunding Bonds, Series 2016	-	199,240	-	199,240	3,980
Total long-term debt	$ 714,060	$ 199,240	$ (239,075)	$ 674,225	$ 30,265

The debt service requirements as of December 31, 2017, are as follows:

Year Ending December 31,	Principal	Interest	Interest Credit (BABs)	Total
2018	$ 17,975	$ 34,535	$ (8,136)	$ 44,374
2019	19,000	33,724	(7,963)	44,761
2020	20,075	32,834	(7,770)	45,139
2021	20,835	31,842	(7,560)	45,117
2022	21,650	30,781	(7,334)	45,097
2023 - 2027	122,640	135,106	(32,557)	225,189
2028 - 2032	152,010	96,382	(23,843)	224,549
2033 - 2037	186,225	50,391	(12,885)	223,731
2038 - 2041	83,550	5,432	(1,624)	87,358
	$ 643,960	$ 451,027	$ (109,672)	$ 985,315

Note 9: Pension Plan

Plan Description and Benefits Provided

The System sponsors a single-employer defined benefit pension plan which covers substantially all of the System's employees who work at least 20 hours per week or at least 1,000 hours annually and were hired before July 1, 2012 under a traditional final average pay formula based on years of service and average earnings at termination. Employees are eligible for participation in the plan after attaining the age of 21 and completing one year of service. All employees with hire dates through June 30, 2012 must participate in the plan as a condition of employment. Employees hired after June 30, 2012 must participate in the Cash Balance Plan and are eligible for participation in the plan after attaining the age of 21 and completing one year of service.

Plan participants have a 100% vested right in the accrued benefits derived from their accumulated contributions. With regard to participants' accrued benefits derived from employer contributions, the participants become fully vested at the completion of five years of vesting service. The System makes contributions which are actuarially determined to pay the plan's total cost less the projected employee contributions.

Final Average Pay Formula

Participants are eligible for normal retirement benefits after attaining age 65 and completing five years of vesting service; or, after age 55 and the number of years of service needed for the sum of the participant's age and years of service to equal 85 years (Rule of 85). Annual normal retirement benefits (accrued benefits) are equal to 1.5% of the participant's average 5 highest years' pay in the last 10 years, times the number of years of credited service.

An early retirement provision is available to participants who attain age 55 and five years of vesting service, but do not satisfy the Rule of 85. The early retirement benefit equals the normal retirement benefit at actual retirement reduced at the rate of 1/15th for each of the first five years before age 65 and 1/30th for each of the next five years before age 65 and the participants actual retirement age.

Pre-retirement death benefits before vesting or attainment of age 55 are equal to the amount of the participant's contributions plus 4.5% interest per annum and may be distributed in a lump sum or in installments up to 60 months. Pre-retirement death benefits on or after eligibility for normal retirement are a monthly benefit payable to named beneficiary equal to 50% of the present actuarial value of the participant's accrued benefit otherwise payable on the participant's date of death.

The System has agreed (but does not guarantee) to voluntarily contribute such amounts as are necessary to maintain the plan on a sound actuarial basis. The System has the right to discontinue such contributions and terminate the plan at any time. However, under no conditions may the System withdraw its contributions, or use them for any purpose other than the exclusive benefit of the plan participants and their beneficiaries; and, to pay for administrative expenses. Participants in the plan contribute 2% of gross pay upon achievement of eligibility and thereafter until the time of retirement or separation from employment with the System.

Match Savings Formula

The System also deposits amounts to the plan to fund a Match Savings Plan to encourage eligible employees to participate in a 457 Deferred Compensation Retirement Savings Plan (457 Plan). Under the Match Savings Plan, the System will match 25% of an employee's contribution to the 457 Plan, up to 4% of compensation. Benefits will be distributed upon retirement or separation from service after satisfying the vesting requirements.

Cash Balance Formula

On June 11, 2012, the plan was amended to stipulate that employees hired by the System after June 30, 2012 shall not be eligible to participate in the plan, except for the Match Savings Plan and the Cash Balance Plan. Other employees rehired after June 30, 2012, shall be treated as subject to this amendment unless they were vested in their accrual benefits prior to the date of being rehired.

Under the terms of the Cash Balance Plan, eligible employees are required to contribute 3% of eligible compensation and the System also contributes 3% of each participating employee's eligible compensation. Plan participants have a 100% vested right in the accrued benefits derived from their accumulated contributions. With regard to participants' accrued benefits derived from employer contributions, the participants become fully vested at the completion of five years of vesting service. Employee and System contributions made on the employees behalf are credited to a hypothetical cash balance account maintained in the Plan's recordkeeping system. As contributions are credited to the employee's account, interest credits are also made to the account, based on the balance of the account on the first day of each Plan quarter. Interest is measured by the actual rate of return of the entire Pension Trust. Upon the employee's retirement or termination of employment, their cash balance account will be credited with at least the total of all of the contributions that have been credited to their account.

(In Thousands)

The employees covered by the Plan at January 1 are:

	2017	2016
Inactive participants:		
Retirees and beneficiaries currently receiving benefits	1,031	935
Terminated employees with deferred benefits	1,523	1,474
Total inactive participants	2,554	2,409
Active participants:		
Fully vested	3,330	3,286
Nonvested	2,534	2,181
Total active participants	5,864	5,467
Total participants	8,418	7,876

Contributions

The Board has the authority to establish and amend the contribution requirements of the System and active employees. The Board establishes rates based on an actuarially determined rate recommended by an independent actuary. The actuarially determined rate is the estimated amount necessary to finance the costs of benefits earned by employees during the year, with an additional amount to finance any unfunded accrued liability. The Board has agreed to contribute the difference between the actuarially determined rate and the contribution rate of employees. For the years ended December 31, 2017 and 2016, employees contributed $6,589 and $6,724 (or 2.1% and 2.4% of covered payroll), and the System contributed $17,891 and $16,903 (or 5.8% and 6.0% of covered payroll), respectively, to the Plan.

Net Pension Liability

The System’s net pension liability was measured as of December 31, 2016 and 2015 for the years ended December 31, 2017 and 2016, respectively, and the total pension liability used to calculate the net pension liability was determined by actuarial valuations as of January 1, 2016 and 2015, respectively. Updated procedures were used to roll forward the total pension liability to the respective measurement dates.

(In Thousands)

The total pension liability in the 2016 and 2015 actuarial valuations was determined using the following actuarial assumptions, applied to all periods included in the measurement:

	2016	2015
Wage inflation	3.5%	4.0%
Salary increases	4.9%	5.1%
Ad hoc cost of living adjustments	N/A	N/A
Investment rate of return	7.0%	7.5%

The salary increases and investment rate of return assumptions are inclusive of inflation. The investment rate of return is net of administrative expenses.

Mortality rates were based on the RP-2000 Mortality Table, projected generationally using scale AA.

The System generally performs an experience study every three to five years. The assumptions used to generate the numbers in these statements were based on an experience study performed in 2016.

The long-term expected rate of return on pension plan investments was based primarily on a reasonable projection of what assets can be expected to earn given existing capital market conditions, adjusted for changes in target portfolio allocations and recent changes in long-term interest rates based on publicly available information. The target allocation and best estimates of geometric rates of return for each major asset class are summarized in the following table:

Asset Class	Target Allocation	Long-Term Expected Real Rate of Return
Domestic equity	29%	4.6%
International equity	24%	4.5%
Fixed income	20%	0.8%
Real estate	10%	3.5%
Private equity	7%	5.1%
Absolute return/Hedge fund	10%	2.8%
Total	100%	

(In Thousands)

Discount Rate

The discount rate used to measure the total pension liability was 7.0% and 7.5% for the years ended December 31, 2017 and 2016, respectively. The projection of cash flows used to determine the discount rate assumed that employee contributions will be made at the current contribution rate and that System contributions will be made at rates equal to the difference between actuarially determined contribution rates and the employee rate. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

Changes in the total pension liability, plan fiduciary net position and the net pension liability for the years ended December 31, 2017 and 2016 are:

	2017		
	Total Pension Liability (a)	**Plan Fiduciary Net Position (b)**	**Net Pension Liability (a) - (b)**
Balance, beginning of year	$ 407,490	$ 267,492	$ 139,998
Service cost	19,175	-	19,175
Interest on total pension liability	29,286	-	29,286
Effect of economic/demographic gains or losses	(4,243)	-	(4,243)
Assumption changes	26,891	-	26,891
Employer contributions	-	17,891	(17,891)
Member contributions	-	6,589	(6,589)
Benefit payments	(16,865)	(16,865)	-
Net investment income	-	19,944	(19,944)
Net changes	54,244	27,559	26,685
Balance, end of year	$ 461,734	$ 295,051	$ 166,683

(In Thousands)

	2016		
	Total Pension Liability (a)	Plan Fiduciary Net Position (b)	Net Pension Liability (a) - (b)
Balance, beginning of year	$ 374,482	$ 256,134	$ 118,348
Service cost	17,036	-	17,036
Interest on total pension liability	28,862	-	28,862
Effect of economic/demographic gains or losses	749	-	749
Employer contributions	-	16,903	(16,903)
Member contributions	-	6,724	(6,724)
Benefit payments	(13,639)	(13,639)	-
Net investment income	-	1,370	(1,370)
Net changes	33,008	11,358	21,650
Balance, end of year	$ 407,490	$ 267,492	$ 139,998

All amounts shown in the above tables are exclusive of the value of the participant Match-Savings accounts and UMA accounts.

The net pension liability of the System has been calculated using a discount rate of 7.0%. The following presents the net pension liability using a discount rate 1% higher and 1% lower than the current rate.

	1% Decrease 6.0%	Current Discount Rate 7.0%	1% Increase 8.0%
System's net pension liability	$ 225,323	$ 166,683	$ 114,651

(In Thousands)

Pension Expense and Deferred Outflows of Resources Related to Pensions

For the years ended December 31, 2017 and 2016, the System recognized pension expense of $30,746 and $24,027, respectively. At December 31, 2017 and 2016 the System reported deferred inflows and outflows of resources related to pensions from the following sources:

	2017	
	Deferred Outflows of Resources	**Deferred Inflows of Resources**
Differences between expected and actual experience	$ 541	$ 3,591
Net difference between projected and actual earnings on pension plan investments	13,459	-
Changes in assumptions	22,753	-
Contributions subsequent to the measurement date	24,296	-
	$ 61,049	$ 3,591

	2016	
	Deferred Outflows of Resources	**Deferred Inflows of Resources**
Differences between expected and actual experience	$ 645	$ -
Net difference between projected and actual earnings on pension plan investments	18,687	-
Contributions subsequent to the measurement date	17,891	-
	$ 37,223	$ -

At December 31, 2017 and 2016, the System reported $24,296 and $17,891, respectively, as deferred outflows of resources related to pensions resulting from System contributions made subsequent to the measurement date that will be recognized as a reduction of the net pension liability at December 31, 2018 and 2017, respectively.

(In Thousands)

Other amounts reported as deferred outflows of resources at December 31, 2017, related to pensions will be recognized in pension expense as follows:

Year ending December 31:		
2018	$	8,496
2019		8,496
2020		7,294
2021		3,524
2022		3,588
Thereafter		1,764
	$	33,162

Deferred Compensation Plan

The Match Savings Plan is a 457 deferred compensation plan that covers substantially all employees meeting age and service requirements. Employee contributions to the plan are discretionary. The System's contributions were approximately $1,497 and $1,622 for the years ended December 31, 2017 and 2016, respectively.

Defined Contribution Plan

UMA has a defined contribution plan covering substantially all UMA employees. Participation in the plan is a condition of employment. Employees are fully vested after five years. Annually, UMA makes a contribution equal to 6.75% of the participant's compensation. Pension expense was approximately $1,297 and $1,056 for 2017 and 2016, respectively.

Note 10: Retiree Health Care Plan (Under GASB Statement No. 74)

Plan Description

The System contributes to the University Health System Other Post-Employment Benefits Plan (OPEB Plan), a single-employer defined benefit OPEB plan covering substantially all employees. The OPEB Plan is administered by the System. Benefit provisions and contribution requirements of plan members and the System are established and may be amended by the Board. The OPEB Plan does not issue a separate report that includes financial statements and required supplementary information for the OPEB Plan.

(In Thousands)

Benefits Provided

The OPEB Plan provides postretirement health care benefits to eligible retirees and their dependents. Benefits are provided through the System's self-insured employee health plan. The cost of the benefits is covered by contributions from the System and OPEB Plan members.

The employees covered by the OPEB Plan at December 31, 2017 and 2016, are:

	2017	2016
Inactive plan members or beneficiaries currently receiving payments	804	747
Active plan members	3,346	3,628
Total inactive participants	4,150	4,375

Contributions

The Board has the authority to establish and amend the contribution requirements of the System and active employees. The required contribution is based on projected pay-as-you-go financing requirements. OPEB Plan members receiving benefits contributed approximately $1,693 and $1,308 in 2017 and 2016, respectively, through their required monthly contributions as shown in the table below:

	2017	2016
Retiree-only coverage	$ 178.08	$ 142.78
Retiree and spouse coverage	338.35	271.27
Retiree and children coverage	333.01	266.99
Retiree and family coverage	625.06	501.14

The cost of benefits not covered by OPEB Plan member contributions are covered by the System. For the years ended December 31, 2017 and 2016, the System contributed $2,437 and $4,094, respectively, to the OPEB Plan.

Net OPEB Liability

The System's net OPEB Plan liability of $5,882 and $9,587 was measured as of December 31, 2017 and 2016, for the years ended December 31, 2017 and 2016, respectively, and the total OPEB Plan liability used to calculate the net OPEB Plan liability was determined by actuarial valuations as of January 1, 2017 and 2016, respectively, and rolled forward to the measurement dates.

(In Thousands)

The total OPEB liability in the January 1, 2017 and 2016 actuarial valuations was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Health care cost trend rates	5.0%
Investment rate of return	7.0%
Retirees' share of benefit-related costs	70.0%

Mortality rates for both active and retired lives were based on the RP-2000 Combined Healthy, with no collar adjustment; projected with generational mortality (Scale AA).

The actuarial value of plan assets is based on market-related value of plan assets, with five-year smoothing of expected returns. The market-related value is equal to the value of the fair value of assets held in trust for OPEB Plan benefits as of the valuation date.

The long-term expected rate of return on the OPEB Plan investments was based primarily on historical returns on plan assets, adjusted for changes in target portfolio allocations and recent changes in long-term interest rates based on publicly available information. The target allocation and best estimates of rates of return presented as geometric means for each major asset class are summarized in the following table:

Asset Class	Target Allocation	Long-Term Expected Real Rate of Return
Domestic equity	75%	4.6%
Fixed income	25%	0.8%
Total	100%	

(In Thousands)

The components of the net OPEB Plan liability of the System at December 31, 2017 and 2016, were as follows:

	2017	2016
Total OPEB liability	$ 51,176	$ 48,191
Less: plan fiduciary net position	45,294	38,604
Net OPEB liability	$ 5,882	$ 9,587
Plan fiduciary net position as a % of total OPEB liability	89%	80%

Discount Rate

The discount rate used to measure the total OPEB Plan liability was 7.0%, for both years ended December 31, 2017 and 2016. The projection of cash flows used to determine the discount rate assumed that System contributions will be made at rates equal to the actuarially determined contribution rates. Based on those assumptions, the OPEB Plan's fiduciary net position was projected to be available to make all projected OPEB Plan payments for current active and inactive employees. Therefore, the long-term expected rate of return on OPEB Plan investments was applied to all periods of projected benefit payments to determine the total OPEB Plan liability.

The liability at December 31, 2017 and 2016 was determined using the entry age normal cost method.

Sensitivity of the Net OPEB Liability to Changes in the Discount Rate and Health Care Cost Trend Rates

The net OPEB Plan liability of the System has been calculated using a discount rate of 7.0%. The following presents the net OPEB liability using a discount rate 1% higher and 1% lower than the current discount rate.

	1% Decrease	Current Discount Rate	1% Increase
System's net OPEB liability - 2017	$ 11,410	$ 5,882	$ 1,175
System's net OPEB liability - 2016	$ 14,787	$ 9,587	$ 5,150

(In Thousands)

The net OPEB liability of the System has been calculated using health care cost trend rates of 5.0%. The following presents the net OPEB liability using health care cost trend rates 1% higher and 1% lower than the current health care cost trend rates.

	1% Decrease	Current Health Care Cost Trend Rates	1% Increase
System's net OPEB liability - 2017	$ 43	$ 5,882	$ 12,957
System's net OPEB liability - 2016	$ 4,083	$ 9,587	$ 16,244

Note 11: Postemployment Health Care Plan (Under GASB Statement No. 45)

Plan Description and Funding Policy

OPEB Plan contribution requirements of plan members and the System are established and may be amended by the Board. The required contribution is based on projected pay-as-you-go financing requirements.

The System did not make any contributions to the OPEB Plan in 2017. The System contributed approximately $1,288 to the plan in 2016, which is exclusive of OPEB Plan member contributions. Plan members receiving benefits contributed approximately $1,693 and $1,308 in 2017 and 2016, respectively, through their required monthly contributions as shown in the below table:

	2017	2016
Retiree-only coverage	$ 178.08	$ 142.78
Retiree and spouse coverage	338.35	271.27
Retiree and children coverage	333.01	266.99
Retiree and family coverage	625.06	501.14

Annual OPEB Cost and Net OPEB Obligation

The System’s annual OPEB Plan cost is calculated based on the annual required contribution (ARC) of the employer, an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed 30 years. The adjustment to the ARC shown in the following table is for the portion of the benefits paid to beneficiaries by the System and is recorded in employee compensation expense on a pay-as-you-go basis.

(In Thousands)

The following table shows the components of the System's annual OPEB Plan cost, the amount actually contributed to the plan and changes in the System's net OPEB Plan obligation to the plan:

	2017	2016
Annual required contribution	$ 2,996	$ 2,292
Adjustment to annual required contribution	(559)	1,802
Annual OPEB cost	2,437	4,094
Contributions made	2,437	4,094
Change in net OPEB obligation	-	-
Net OPEB obligation - beginning of year	-	-
Net OPEB obligation - end of year	$ -	$ -

The System's annual OPEB Plan cost, the percentage of annual OPEB Plan cost contributed to the plan and the net OPEB Plan obligation for 2017 and the two preceding years were as follows:

Fiscal Year-End	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
12/31/2017	$ 2,437	100%	$ -
12/31/2016	$ 4,094	100%	$ -
12/31/2015	$ 3,604	100%	$ -

Funded Status and Funding Progress

As of January 1, 2016, the most recent actuarial valuation date, the plan was 69.0% funded. The actuarial accrued liability for benefits was approximately $48,675, and the actuarial value of assets was approximately $33,596, resulting in a UAAL of $15,079.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality and the health care cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

Actuarial Methods and Assumptions

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

In the January 1, 2016, actuarial valuation, the projected unit credit method was used. The actuarial assumptions included a 7.0% investment rate of return (net of administrative expenses), and an annual health care cost trend rate of 5.0%. The actuarial value of assets was determined using techniques that spread the effects of short-term volatility in the market value of investments over a five-year period. The UAAL is being amortized as a level percentage of projected payroll on an open basis over a 30 year period.

Note 12: Affiliation Agreement

The System has entered into a long-standing affiliation agreement with UT Health. Under the agreement, the System's facilities serve as the major teaching facilities for many of UT Health's health care programs, including the graduate medical education program. The System incurred expenses of approximately $13,769 and $13,201 in 2017 and 2016, respectively, under the terms of the agreement.

Note 13: Disclosures About Fair Value of Investments

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value measurements must maximize the use of observable inputs and minimize the use of unobservable inputs. There is a hierarchy of three levels of inputs that may be used to measure fair value:

Level 1 Quoted prices in active markets for identical assets or liabilities

Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities

(In Thousands)

Level 3 Unobservable inputs supported by little or no market activity and are significant to the fair value of the assets or liabilities

Recurring Measurements

The following table presents the fair value measurements of assets recognized in the accompanying balance sheets measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall at December 31, 2017 and 2016:

Type	Fair Value	Fair Value Measurements Using: Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2017				
Investments by fair value level				
U.S. Treasury obligations	$ 42,461	$ -	$ 42,461	$ -
U.S. agencies obligations	276,846	-	276,846	-
Municipal bonds	4,270	-	4,270	-
Commercial paper	217,594	-	217,594	-
Money market mutual funds	156,433	156,433	-	-
Total investments by fair value level	697,604	$ 156,433	$ 541,171	$ -
Investment pool carried at amortized cost	250,714			
Total investments	$ 948,318			
December 31, 2016				
Investments by fair value level				
U.S. Treasury obligations	$ 13,347	$ -	$ 13,347	$ -
U.S. agencies obligations	278,144	-	278,144	-
Municipal bonds	4,354	-	4,354	-
Commercial paper	99,392	-	99,392	-
Money market mutual funds	217,133	217,133	-	-
Corporate bonds	5,151	-	5,151	-
Total investments by fair value level	$ 617,521	$ 217,133	$ 400,388	$ -
Investment pool carried at amortized cost	196,325			
Total investments by fair value level	$ 813,846			

(In Thousands)

Investments

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. If quoted market prices are not available, then fair values are estimated by using quoted prices of securities with similar characteristics or independent asset pricing services and pricing models, the inputs of which are market-based or independently sourced market parameters, including, but not limited to, yield curves, interest rates, volatilities, prepayments, defaults, cumulative loss projections and cash flows. Such securities are classified in Level 2 of the valuation hierarchy. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy. The System held no Level 3 investments at December 31, 2017 or 2016.

Note 14: Condensed Combining Information

The following tables include condensed combining balance sheet information for the System and its blended component unit as of December 31, 2017 and 2016:

	December 31, 2017			
	System	CFHP	Eliminations	Total
Assets				
Current assets	$ 840,653	$ 110,982	$ (2,100)	$ 949,535
Capital assets, net	1,164,437	4,585	-	1,169,022
Other assets	451,231	45,361	-	496,592
Total assets	2,456,321	160,928	(2,100)	2,615,149
Deferred Outflows of Resources	75,423	-	-	75,423
Total assets and deferred outflows of resources	$ 2,531,744	$ 160,928	$ (2,100)	$ 2,690,572
Liabilities				
Current liabilities	$ 248,734	$ 69,483	$ (2,100)	$ 316,117
Noncurrent liabilities	823,959	-	-	823,959
Total liabilities	1,072,693	69,483	(2,100)	1,140,076
Deferred Inflows of Resources	430,984	-	-	430,984
Net Position				
Net investments in capital assets	502,886	4,585	-	507,471
Restricted expendable	32,714	7,323	-	40,037
Unrestricted	492,467	79,537	-	572,004
Total net position	1,028,067	91,445	-	1,119,512
Total liabilities, deferred inflows of resources and net position	$ 2,531,744	$ 160,928	$ (2,100)	$ 2,690,572

(In Thousands)

	December 31, 2016			
	System	CFHP	Eliminations	Total
Assets				
Current assets	$ 792,204	$ 112,587	$ (5,978)	$ 898,813
Capital assets, net	1,196,315	2,974	-	1,199,289
Other assets	389,049	42,577	-	431,626
Total assets	2,377,568	158,138	(5,978)	2,529,728
Deferred Outflows of Resources	52,367	-	-	52,367
Total assets and deferred outflows of resources	$ 2,429,935	$ 158,138	$ (5,978)	$ 2,582,095
Liabilities				
Current liabilities	$ 244,957	$ 62,815	$ (5,978)	$ 301,794
Noncurrent liabilities	816,405	-	-	816,405
Total liabilities	1,061,362	62,815	(5,978)	1,118,199
Deferred Inflows of Resources	398,797	-	-	398,797
Net Position				
Net investments in capital assets	499,138	2,974	-	502,112
Restricted expendable	20,194	2,101	-	22,295
Unrestricted	450,444	90,248	-	540,692
Total net position	969,776	95,323	-	1,065,099
Total liabilities, deferred inflows of resources and net position	$ 2,429,935	$ 158,138	$ (5,978)	$ 2,582,095

(In Thousands)

The following tables include condensed combining statements of revenues, expenses and changes in net position information for the System and its blended component unit for the years ended December 31, 2017 and 2016:

	Year Ended December 31, 2017			
	System	CFHP	Eliminations	Total
Operating Revenues				
Net patient service revenue	$ 769,459	$ -	$ -	$ 769,459
Premium revenue	-	496,472	-	496,472
Other	65,178	22,130	(5,810)	81,498
Total operating revenues	834,637	518,602	(5,810)	1,347,429
Operating Expenses				
Salaries and wages	541,550	26,045	(3,200)	564,395
Purchased services, supplies and other	543,646	46,373	(2,610)	587,409
Medical claims expense	-	450,462	-	450,462
Depreciation	81,681	845	-	82,526
Total operating expenses	1,166,877	523,725	(5,810)	1,684,792
Operating Loss	(332,240)	(5,123)	-	(337,363)
Nonoperating Revenues				
Property tax revenue, net	399,652	-	-	399,652
Interest expense	(32,347)	-	-	(32,347)
Other, net	23,226	1,245	-	24,471
Total nonoperating revenues, net	390,531	1,245	-	391,776
Increase (Decrease) in Net Position	58,291	(3,878)	-	54,413
Net Position, Beginning of Year	969,776	95,323	-	1,065,099
Net Position, End of Year	$ 1,028,067	$ 91,445	$ -	$ 1,119,512

(In Thousands)

	Year Ended December 31, 2016			
	System	CFHP	Eliminations	Total
Operating Revenues				
Net patient service revenue	$ 754,014	$ -	$ -	$ 754,014
Premium revenue	-	391,048	-	391,048
Other	55,723	40,196	(4,228)	91,691
Total operating revenues	809,737	431,244	(4,228)	1,236,753
Operating Expenses				
Salaries and wages	508,106	19,987	(1,784)	526,309
Purchased services, supplies and other	507,131	55,943	(2,444)	560,630
Medical claims expense	-	336,398	-	336,398
Depreciation	78,410	709	-	79,119
Total operating expenses	1,093,647	413,037	(4,228)	1,502,456
Operating Income (Loss)	(283,910)	18,207	-	(265,703)
Nonoperating Revenues				
Property tax revenue, net	366,930	-	-	366,930
Interest expense	(35,987)	-	-	(35,987)
Other, net	15,789	729	-	16,518
Total nonoperating revenues, net	346,732	729	-	347,461
Increase in Net Position	62,822	18,936	-	81,758
Net Position, Beginning of Year	906,954	76,387	-	983,341
Net Position, End of Year	$ 969,776	$ 95,323	$ -	$ 1,065,099

(In Thousands)

The following tables include condensed combining statements of cash flows information for the System and its blended component unit for the years ended December 31, 2017 and 2016:

	Year Ended December 31, 2017		
	System	**CFHP**	**Total**
Net cash provided by (used in)			
Operating activities	$ (277,569)	$ (1,197)	$ (278,766)
Noncapital financing activities	420,140	-	420,140
Capital and related financing activities	(40,175)	(2,456)	(42,631)
Investing activities	(182,196)	(30,581)	(212,777)
Decrease in cash and cash equivalents	(79,800)	(34,234)	(114,034)
Cash and cash equivalents, beginning of year	122,901	77,646	200,547
Cash and cash equivalents, end of year	$ 43,101	$ 43,412	$ 86,513

	Year Ended December 31, 2016		
	System	**CFHP**	**Total**
Net cash provided by (used in)			
Operating activities	$ (156,818)	$ 39,183	$ (117,635)
Noncapital financing activities	276,843	-	276,843
Capital and related financing activities	(82,929)	(1,437)	(84,366)
Investing activities	(168,160)	7,564	(160,596)
Increase (decrease) in cash and cash equivalents	(131,064)	45,310	(85,754)
Cash and cash equivalents, beginning of year	253,965	32,336	286,301
Cash and cash equivalents, end of year	$ 122,901	$ 77,646	$ 200,547

Note 15: Future Change in Accounting Principles

In June 2015, the Governmental Accounting Standards Board issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions* (GASB 75). Principal objectives of GASB 75 are to improve accounting and financial reporting by state and local governments for OPEB and to improve information provided by state and local employers about financial support for OPEB that is provided by other entities. OPEB includes, among other things, postemployment healthcare benefits (medical, dental, vision, hearing and other health-related benefits), death benefits, life insurance, disability and long-term care. GASB 75 supersedes GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, and is applicable to employers providing defined benefit OPEB to their employees through OPEB plans that are administered through trusts that meet certain specified criteria, to employers providing defined contribution OPEB to their employees, and to employers providing defined benefit OPEB through OPEB plans that are not administered through trusts that meet the specified criteria of GASB 75. It also addresses certain circumstances in which a nonemployer entity provides financial support for OPEB of employees of another entity. GASB 75 requires employers providing defined benefit OPEB to their employees to recognize a net OPEB liability, or its proportionate share of such liability for cost-sharing multiple-employer plans, for the portion of the actuarial present value of projected benefit payments to be provided to current active and inactive employees that is attributed to past periods of employee service, less any OPEB plan fiduciary net position. It also provides guidance on determining OPEB expense, deferred outflows and inflows of resources, note disclosures and required supplementary information. The requirements of GASB 75 are applicable for fiscal years beginning after June 15, 2017, thus, it will be applicable to the System for the year ending December 31, 2018. The impact of adopting GASB 75 on the System’s financial statements is not currently determinable.

In January 2017, GASB issued Statement No. 84, *Fiduciary Activities* (GASB 84), which establishes criteria for identifying fiduciary activities of all state and local governments. The focus of the criteria generally is on (1) whether a government is controlling the assets of the fiduciary activity and (2) the beneficiaries with whom a fiduciary relationship exists. Separate criteria are included to identify fiduciary component units and postemployment benefit arrangements that are fiduciary activities. The requirements of GASB 84 are applicable for fiscal years beginning after December 15, 2018, thus, it will be applicable to the System for the year ending December 31, 2019. The impact of adopting GASB 84 on the System’s financial statements is not currently determinable.

Note 16: Contingencies

Litigation

In the normal course of business, the System is, from time to time, subject to allegations that may or do result in litigation. Some of these allegations are in areas not covered by the System’s self-insurance program (discussed elsewhere in these notes) or by commercial insurance; for example, allegations regarding employment practices or performance of contracts. The System evaluates such allegations by conducting investigations to determine the validity of each potential claim. Based upon the advice of legal counsel, management records an estimate of the amount of ultimate expected loss, if any, for each. Events could occur that would cause the estimate of ultimate loss to differ materially in the near term.

Note 17: Subsequent Events

Subsequent to year-end, the System issued the combination tax and revenue Certificates of Obligation, Series 2018 (the 2018 Certificates) in the amount of $283,565, dated April 15, 2018. The 2018 Certificates mature in various amounts annually starting February 15, 2019 through February 15, 2048, with stated coupon rates ranging from 2.5% to 5.0%. The 2018 Certificates are collateralized by a levy of ad valorem tax revenue and lien on and pledge of surplus revenues. Proceeds from the 2018 Certificates will primarily be used to fund the construction and equipping of a women's and children's tower project as well as a heart and vascular institute and an advanced endoscopy services facilities, among other facility improvements.

Required Supplementary Information

Bexar County Hospital District
d/b/a University Health System
A Component Unit of Bexar County, Texas
Changes in the System's Net Pension Liability and Related Ratios
(In Thousands)

	2017	2016	2015
Total Pension Liability			
Service cost	$ 19,175	$ 17,036	$ 16,627
Interest	29,286	28,862	26,615
Effect of economic/demographic gains or losses	(4,243)	749	-
Changes of assumptions	26,891	-	-
Benefit payments, including refunds of employee contributions	(16,865)	(13,639)	(13,749)
Net Change in Total Pension Liability	54,244	33,008	29,493
Total Pension Liability - Beginning	407,490	374,482	344,989
Total Pension Liability - Ending (a)	$ 461,734	$ 407,490	$ 374,482
Plan Fiduciary Net Position			
Contributions - employer	$ 17,891	$ 16,903	$ 16,297
Contributions - employee	6,589	6,724	5,742
Net investment income	19,944	1,370	12,564
Benefit payments, including refunds of employee contributions	(16,865)	(13,639)	(13,749)
Net Change in Plan Fiduciary Net Position	27,559	11,358	20,854
Plan Fiduciary Net Position - Beginning	267,492	256,134	235,280
Plan Fiduciary Net Position - Ending (b)	$ 295,051	$ 267,492	$ 256,134
System's Net Pension Liability - Ending (a) - (b)	$ 166,683	$ 139,998	$ 118,348
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	63.90%	65.64%	68.40%
Covered Payroll	$ 307,617	$ 280,165	$ 254,100
System's Net Pension Liability as a Percentage of Covered Payroll	54.19%	49.97%	46.58%

Notes to Schedule:
Changes of assumptions:
1. Rate of salary increase changed from 5.1% to 4.9%.
2. Wage inflation rate changed from 4.0% to 3.5%.
3. Investment rate of return decreased from 7.5% to 7.0%.

This schedule is presented to illustrate the requirement to show information for 10 years. However, until a full 10-year trend is compiled, the System will present information for those years for which information is available. All amounts are in thousands, unless otherwise indicated. This information is presented as of the measurement date.

Bexar County Hospital District
d/b/a University Health System
A Component Unit of Bexar County, Texas
Schedule of System Pension Contributions
(In Thousands)

Year Ending December 31,	Actuarially determined contribution	Contributions in relation to the actuarially determined contribution	Contribution deficiency (excess)	Covered payroll	Contributions as a percentage of covered payroll
2017	$ 21,296	$ 24,296	$ (3,000)	$ 331,014	7.3%
2016	17,891	17,891	-	307,617	5.8%
2015	17,697	17,697	-	280,165	6.3%

Notes to Schedule:

Valuation date:
Actuarially determined contribution rates are calculated as of January 1, one year prior to the end of the fiscal year in which the contributions are reported.

Methods and assumptions used to determine contribution rates:

Actuarial cost method:	Entry age normal cost
Amortization method:	Closed
Remaining amortization period:	28
Asset valuation method:	5-year smoothed market
Inflation:	3.5%
Salary increases:	3.92% - 6.25%, based on age and years of service, including inflation
Investment rate of return:	7.0%, net of pension plan investment expense, including inflation
Retirement age:	Annual rates based on age and age at satisfaction of rule of 85 for participants that meet the rule of 85 prior to age 65.
Mortality - Active Lives:	RP-2000 Combined Healthy; with no collar adjustment; projected with Generational Mortality (Scale AA)
Mortality - Retired Lives:	RP-2000 Combined Healthy; with no collar adjustment; projected with Generational Mortality (Scale AA)
Other information:	Plan is frozen to new participants effective June 30, 2012

This schedule is presented to illustrate the requirement to show information for 10 years. However, until a full 10-year trend is compiled, the System will present information for those years for which information is available. All amounts are in thousands unless otherwise indicated. This information is presented for the System's fiscal year.

Bexar County Hospital District
d/b/a University Health System
Schedule of Funding Progress – Retiree Health Plan
December 31, 2017
(In Thousands)

Actuarial Valuation Date	Actuarial Value of Plan Assets	Actuarial Accrued Liability (AAL)	Plan Assets Less than AAL	Funded Ratio
January 1, 2016	$ 33,596	$ 48,675	$ (15,079)	69.0%
January 1, 2015	$ 29,732	$ 39,287	$ (9,555)	75.7%
January 1, 2014	$ 25,706	$ 34,324	$ (8,618)	74.9%

Bexar County Hospital District
d/b/a University Health System
Schedule of Changes in Net OPEB Liability and Related Ratios
December 31, 2017
(In Thousands)

	2017	2016
Total OPEB Liability		
Service cost	$ 2,437	$ 2,587
Interest	3,444	3,234
Expected benefit payments	(2,896)	(2,439)
Net Change in Total OPEB Liability	2,985	3,382
Total OPEB Liability - Beginning	48,191	44,809
Total OPEB Liability - Ending (a)	$ 51,176	$ 48,191
Plan Fiduciary Net Position		
Contributions - employer	$ 2,437	$ 4,094
Benefit payments	(2,437)	(3,202)
Net investment income	6,734	3,623
Administrative expenses	(44)	(28)
Net Change in Plan Fiduciary Net Position	6,690	4,487
Plan Fiduciary Net Position - Beginning	38,604	34,117
Plan Fiduciary Net Position - Ending (b)	$ 45,294	$ 38,604
System's Net OPEB Liability - Ending (a) - (b)	$ 5,882	$ 9,587
Plan Fiduciary Net Position as a Percentage of the Total OPEB Liability	88.51%	80.11%
Covered Employee Payroll	$ 189,368	$ 200,995
System's Net OPEB Liability as a Percentage of Covered Employee Payroll	3.11%	4.77%

This schedule is presented to illustrate the requirement to show information for 10 years. However, until a full 10-year trend is compiled, the System will present information for those years for which information is available. All amounts are in thousands, unless otherwise indicated. This information is presented as of the measurement date.

Bexar County Hospital District
d/b/a University Health System
Schedule of System OPEB Contributions
December 31, 2017
(In Thousands)

Year Ending December 31,	Actuarially determined contribution	Contributions in relation to the actuarially determined contribution	Contribution excess (deficiency)	Covered Employee Payroll	Contributions as a percentage of covered payroll
2017	$ 2,996	$ 2,437	$ (559)	$ 189,368	1.3%
2016	2,292	4,094	1,802	200,995	2.0%

Notes to Schedule:

Valuation date:
Actuarially determined contribution rates are calculated as of January 1, one year prior to the end of the fiscal year in which the contributions are reported.

Methods and assumptions used to determine contribution rates:

Actuarial cost method:	Entry age normal cost in 2017, projected unit credit in 2016
Amortization method:	Level percentage open
Remaining amortization period:	30
Asset valuation method:	5-year smoothed market
Inflation:	N/A
Salary increases:	3.5%
Investment rate of return:	7.0%, net of OPEB plan investment expense, including inflation
Retirement age:	Annual rates based on age and age at satisfaction of rule of 85 for participants that meet the rule of 85 prior to age 65.
Mortality - Active Lives:	RP-2000 Combined Healthy; with no collar adjustment; projected with Generational Mortality (Scale AA)
Mortality - Retired Lives:	RP-2000 Combined Healthy; with no collar adjustment; projected with Generational Mortality (Scale AA)

This schedule is presented to illustrate the requirement to show information for 10 years. However, until a full 10-year trend is compiled, the System will present information for those years for which information is available. All amounts are in thousands unless otherwise indicated. This information is presented for the System's fiscal year.

Bexar County Hospital District
d/b/a University Health System
Schedule of Investment Return – Retiree Health Trust
December 31, 2017
(In Thousands)

	2017	2016
Annual money-weighted rate of return, net of investment expense	10%	1%

This schedule is presented to illustrate the requirement to show information for 10 years. However, until a full 10-year trend is compiled, the System will present information for those years for which information is available. This information is presented for the System's fiscal year

BKD LLP
CPAs & Advisors
14241 Dallas Parkway, Suite 1100 // Dallas, TX 75254-2961
972.702.8262 // fax 972.702.0673 // bkd.com

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

Independent Auditor's Report

Board of Managers
Bexar County Hospital District
d/b/a University Health System
San Antonio, Texas

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of the business-type activities, the discretely presented component unit and the aggregate remaining fiduciary fund information of Bexar County Hospital District d/b/a University Health System (the System), collectively a component unit of Bexar County, Texas, as of and for the year ended December 31, 2017, and the related notes to the financial statements, which collectively comprise the System's basic financial statements and have issued our report thereon dated May 23, 2018. Our report contained an "Emphasis of Matter" paragraph regarding a change in accounting principle. Our report also includes a reference to other auditors who audited the financial statements of the University Health System Pension Plan (Pension Plan), as described in our report on the System's financial statements. The financial statements of the Pension Plan and Community First Health Plans, which are included in the System's financial statements, were not audited in accordance with *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the System's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control. Accordingly, we do not express an opinion on the effectiveness of the System's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the System's financial statements will not be prevented or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

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

Purpose of This Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the System’s internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

BKD, LLP

Dallas, Texas
May 23, 2018