University Health System
A Component Unit of Bexar County, Texas

Years Ended December 31, 2012 and 2011

With Report of Independent Auditor's

BASIC FINANCIAL STATEMENTS, REQUIRED SUPPLEMENTARY INFORMATION, AND OTHER FINANCIAL INFORMATION

BKD LLP
CPAs & Advisors

University Health System
A Component Unit of Bexar County, Texas

Basic Financial Statements, Required Supplementary Information,
and Other Financial Information

Years Ended December 31, 2012 and 2011

Contents

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Independent Auditor's Report on Financial Statements and Supplementary Information

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 Bexar County Hospital District d/b/a University Health System (the System), and its discretely presented component units, collectively a component unit of Bexar County, Texas, which comprise the balance sheet as of December 31, 2012, and the statements of revenues, expenses and changes in net position and cash flows for the year then ended, and the related notes to the 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 an opinion on these financial statements based on our audit. We did not audit the financial statements of University Health System Pension Plan (the Pension Plan), a discretely presented component unit 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 other auditors. We conducted our audit 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*. 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 were not audited in accordance with *Governmental 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.

Opinion

In our opinion, based on our audit and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the System and its discretely presented component units as of December 31, 2012, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Prior Year Audited by Other Auditors

The 2011 financial statements were audited by other auditors and their report thereon, dated June 14, 2012, expressed an unmodified opinion.

Change in Accounting Principle

As discussed in Note 2 to the financial statements, in 2012, the System changed its method of accounting for supplies inventory. Our opinion is not modified with respect to this matter.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and pension 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 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.

Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The schedule of expenditures of federal and state awards listed in the table of contents is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards,* we have also issued our report dated June 18, 2013, on our consideration of the System's internal control over financial reporting and 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 on our compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

BKD, LLP

Dallas, Texas
June 18, 2013

Required Financial Statements

The basic financial statements report information using Governmental Accounting Standards Board (GASB) accounting principles. The basic financial statements include the financial statements of the Bexar County Hospital District d/b/a University Health System (the System), the University Health System Pension Plan (the Plan), and the University Health System Retiree Health Trust (the OPEB Trust). The Plan's audited financial statements are available at the System's offices in San Antonio, Texas. The System's basic financial statements offer short-term and long-term financial information about its activities. The balance sheet includes all of the System's assets and liabilities and provides information about the nature and amounts of investments in resources (assets) and the obligations to the System creditors and bond holders (liabilities). It also provides the basis for computing rate of return, evaluating the capital structure of the System, and assessing the liquidity and financial flexibility of the System. All of the current year's revenues and expenses are accounted for in the statement of revenue, expenses, and changes in net position. This statement measures changes in the System's operations over the past two years and can be used to determine whether the System has been able to recover all of its costs through its ad valorem taxes (property taxes) provided, patient service revenue, and other revenue sources. The final required financial statement is the statement of cash flows. The primary purpose of this statement is to provide information about the System's cash from operations, investing, and financing activities and to provide answers to such questions as where did cash come from, what was cash used for, and what was the change in cash balance during the reporting period.

Management's Discussion and Analysis

The 2012 Year in Review

Transforming is an appropriate word to broadly categorize the work that was done in 2012, and is continuing in 2013, to advance the System. Visible signs are apparent through the Capital Improvement Program (CIP) projects with the completion of the new clinic building at the Robert B. Green Campus downtown and continuing work on a new tower for University Hospital in the Medical Center (completion scheduled for the first quarter of 2014). Less visible to the eye, but absolutely critical to the System's ability to be successful in the new state-of-the-art facilities, are the transformational initiatives and programs in 2012 that have enabled significant progress toward our Triple Aim *Plus* goals to improve:

- Quality and Outcomes
- The Patient Experience
- Efficiencies
- *Plus*, Access to Care

2012 Financial Outcomes:

- Strong balance sheet and positive bottom-line results achieved
- Increased funded-payor mix thru service line growth
- Optimized potential value under the Texas Transformation and Quality Improvement Program 1115 Waiver (the Waiver)

2012 Highlights:

In addition to the System's positive financial performance, a host of significant accomplishments in 2012 are already directly and positively impacting our patients, and positioning the Health System to effectively meet the challenges and opportunities related to healthcare reform and the Waiver. Highlights of key initiatives and their outcomes include:

Quality and Outcomes:

- First hospital in South Texas that received Level II Pediatric Trauma Center designation by the American College of Surgeons
- South Texas' first Emergency Medicine Residency program was created
- Opened one of the first Texas Transcatheter Aortic Valve Replacement (TAVR) programs for high-risk patients needing aortic valve replacement
- Received the Platinum quality award for the care of heart attack patients and the Gold quality award for the care of stroke patients from the American Heart Association
- Awarded the National Quality Measure for Breast Centers (NQMBC) certification

The Patient Experience:

- Implemented a new customer service training for all System staff
- Aligned patient experience efforts with the medical staff and experienced improvement positive trends in patient satisfaction scores
- Developed a staff interpretation training program for bi-lingual staff
- Established a Palliative Care program
- Improved processes & reduced wait times in the Emergency Center
- Established a centering pregnancy program

Efficiencies:

- Under the Waiver, the System served as the anchor for the Texas Regional Healthcare Partnership (RHP) Region 6 and coordinated the development of a Delivery System Reform & Incentive Payments plan (DSRIP) for the region. In addition twenty three DSRIP plans were developed and an Uncompensated Care (UC) tool was completed to ensure fair benefits for the System under the Waiver.
- Implemented a lean methodology program called Operational Excellence to streamline work in ways that benefit patients, providers and staff

- Successful partnership developed to find efficiencies, maximize resources and reduce expense and maximize revenue opportunities
- Implemented a new financial management and accountability tool to track patient volumes and financial performance
- Named to Health Care's Most Wired list for success with electronic health records

Access to Care:

- Partnered with a local Federally Qualified Healthcare Center (FQHC) to expand OB/GYN services
- Achieved positive first year results for the mobile mammography unit
- Community Medicine Associates (CMA) the System's physician practice experienced growth in providers & development of medical homes
- Completed the new six story clinical services building on the Robert B. Green Campus

Financial Highlights

- The System's net position increased by $99.6 million (13.7%) in 2012, excluding the impact of change in accounting principle, and $75.7 million (10.4%) in 2011, given the results of operating and nonoperating activities.

- During 2012, the System's total operating revenue increased by $67.7 million or 9.6%, while expenses increased by $38.4 million or 4.1%.

- During 2011, the System's total operating revenue increased by $28.9 million or 4.3%, while expenses increased by $16.5 million or 1.8%.

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.

Net Position

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

TABLE 1
Condensed Balance Sheets
(In Millions)

	December 31		
	2012	**2011**	**2010**
Current and other assets	**$ 1,219**	$ 1,421	$ 1,545
Capital assets	**889**	569	366
Total assets	**$ 2,108**	$ 1,990	$ 1,911
Long-term debt outstanding	**$ 721**	$ 733	$ 745
Deferred tax revenue	**285**	280	279
Other liabilities	**189**	172	158
Total liabilities	**$ 1,195**	$ 1,185	$ 1,182
Net investment in capital assets	**$ 425**	$ 373	$ 223
Restricted	**3**	2	2
Unrestricted	**485**	430	504
Total net position	**$ 913**	$ 805	$ 729

As seen in Table 1, net position increased by $108 million to $913 million in fiscal year 2012, up from $805 million in fiscal year 2011. Net position increased by $76 million to $805 million in fiscal year 2011, up from $729 million in fiscal year 2010. The change in net position results primarily from reductions in losses from operations, achieved through efficiency measures discussed above and revenue recognized from the Waiver.

Summary of Revenue, 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, 2012, 2011, and 2010:

TABLE 2
Condensed Statements of Revenue, Expenses, and Changes in Net Position
(In Thousands)

	Year Ended December 31		
	2012	**2011**	**2010**
Net patient service revenue	**$ 462,133**	$ 386,160	$ 360,380
Premium revenue	**261,717**	265,307	268,562
Other operating revenue	**49,257**	53,944	48,155
Total operating revenue	**773,107**	705,411	677,097
Maintenance and operation expenses	**686,888**	668,787	641,085
Medical claims expense	**237,812**	221,652	234,700
Depreciation expense	**43,220**	39,100	37,208
Total operating expenses	**967,920**	929,539	912,993
Operating loss	**(194,813)**	(224,128)	(235,896)
Nonoperating revenue	**294,461**	299,840	294,768
Excess of revenues over expenses	**99,648**	75,712	58,872
Total net position – beginning of year, as previously reported	**804,772**	729,060	670,188
Cumulative effect of change in accounting principle	**8,900**	-	-
Total net position – beginning of year, as adjusted	**813,672**	729,060	670,188
Total net position – end of year	**$ 913,320**	$ 804,772	$ 729,060

The cumulative effect of change in accounting principle is discussed in *Note 2* following the basic financial statements.

Sources of Revenue

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

TABLE 3
Sources of Revenue by Percentage

	Year Ended December 31		
	2012	**2011**	2010
Operating revenue:			
Net patient service revenue	**43.3%**	38.4%	37.1%
Premium revenue	**24.5**	26.4	27.7
Other operating revenue	**4.6**	5.4	4.9
Total operating revenue	**72.4**	70.2	69.7
Nonoperating revenue (expense):			
Property taxes	**26.3**	28.1	28.3
Investment income	**.3**	.3	.5
Proceeds from tobacco settlement	**.5**	.6	.6
Build America Bond interest subsidy	**.8**	.9	.9
Interest expense	**(.3)**	(.1)	-
Total nonoperating revenue	**27.6**	29.8	30.3
Total revenue	**100.0%**	100.0%	100.0%

Operating Revenue

During fiscal year 2012, the System derived approximately 72.4% of its total revenue from operating revenue, compared to 70.2% in fiscal year 2011. During fiscal year 2011, the System derived approximately 70.2% of its total revenue from operating revenue, compared to 69.7% in fiscal year 2010. Operating revenue increased as a percentage of total revenue due to an increase in net patient revenue.

Table 4 presents the relative percentages of gross charges billed for patient services by payor for the fiscal years ended December 31, 2012, 2011, and 2010:

TABLE 4
Payor Mix by Percentage

	Year Ended December 31		
	2012	**2011**	**2010**
Medicare	**20%**	20%	19%
Medicaid	**19**	22	19
Self-pay	**36**	40	43
Commercial insurance	**24**	17	18
Other	**1**	1	1
Total	**100%**	100%	100%

Nonoperating Revenue

During fiscal year 2012, the System derived 26.3% of its total revenue from ad valorem taxes (property taxes), compared to 28.1% in fiscal year 2011. The percent of property tax revenue to total revenue remained relatively consistent for 2011 and 2010. The 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, 2012, 2011 and 2010, respectively, investment income comprised 0.3% and 0.3% and 0.5% respectively, of total revenue and was made up of interest income, net realized gains/losses, and net unrealized market gains/losses. Investment income continued to be a lower percentage of total income due to lower interest rates caused by national declines in economic and market conditions.

For the years ended December 31, 2012, 2011 and 2010, tobacco revenue comprised 0.5%, 0.6%, and 0.6%, respectively, of total revenue 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, 2012, 2011 and 2010, the BABs interest subsidy comprised 0.8% and 0.9%, and 0.9% respectively of total revenue and was made up of the $8.9 million in funds paid by the U.S. Treasury to subsidize interest costs on the BABs bond issuances.

Operating and Financial Performance

Overall activity at the System, as measured by patient discharges adjusted for outpatient activity, increased 6.6% to 40,518 in 2012 from 37,864 in 2011. The increase in 2012 was due primarily to discharges at University Hospital, where significant growth occurred in the Cardiology, Trauma and Gastroenterology service lines and other growth in the Neonatology service line.

In 2012, net patient service revenue increased by $76.0 million to $462.1 million or 19.7% related to increases in the mix of commercially insured patients, and third party carriers, an increase in the Medicaid SDA rate, initiatives to reduce days in accounts receivable and to reduce denials, and higher reimbursement from Texas Medicaid supplemental funding programs. Net patient service revenue increased by $25.8 million to $386.2 million in 2011 or 7.2%. Operating revenue includes, patient service revenue provided under the Medicare and Medicaid programs, patients or their third-party carriers who pay for care in the System's facilities, health maintenance organization (HMO) premium revenue, Texas Medicaid supplemental payment programs (Disproportionate share (DSH)/Upper Payment Limit (UPL), UC and DSRIP programs under the 1115 Waiver), cafeteria sales, parking fees, grants, research, reimbursement for funding programs, physician practice and resident expenses, meaningful use revenue and funds for uncompensated trauma care. The System recognized premium revenue through its not-for-profit HMO subsidiary, Community First Health Plans (CFHP). During 2012, premium revenue decreased $3.6 million to $261.7 million or 1.4%. The decrease in premium revenue resulted from a continued transition to lower premium members that occurred in 2012. During 2011, premium revenue decreased by $3.3 million to $265.3 million or 1.2%.

The decrease in premium revenue resulted from reduced premiums for Medicaid products that became effective September 1, 2011, and for a transition to lower premium members that occurred in 2011.

Other operating revenue of $49.3 million decreased by $4.7 million or 8.7% in 2012 from $53.9 million in 2011. In 2011, other operating revenue of $53.9 million increased by $5.8 million or 12.0% from $48.2 million in 2010.

Overall, total operating revenue of $773.1 million increased by $67.7 million or 9.6% in 2012, compared to the total of $705.4 million in 2011 that increased by $28.3 million or 4.3%.

Maintenance and operation expenses consist of employee compensation and non-wage expenses, Overall maintenance and operation expenses of $686.9 million increased by $18.1 million or 2.7% in 2012, compared to the total of $668.8 million in 2011. In 2011, overall maintenance and operation expenses increased by $27.7 million. Significant variances are as follows:

- Employee compensation increased by $13.4 million or 4.3% in 2012 and $9.8 million or 3.3% in 2011. The System increased salaries to employees by $9.6 million in 2012 and $8.6 million in 2011. The increases are attributed to increased staffing, related to increased activity in the hospital and clinic expansion initiatives.

- Supplies increased by $4.9 million or 4.4% in 2012 and decreased $1.0 million or 0.9% in 2011. The increase in 2012 resulted from higher activity and utilization of energy devices in the OR. The decrease in 2011 was the result of management initiatives to reduce the cost of blood products and negotiate lower pricing on supplies.

- Medical services increased by $2.2 million or 1.7% in 2012 and by $10.0 million or 8.4% in 2011. Contributing to the increase in 2012 was additional providers for the physician group practice to develop medical home models in the ambulatory setting.

Medical claims expense at CFHP increased by $16.2 million or 7.3% in 2012, and decreased by $13.0 million or 5.6% in 2011.

Depreciation and amortization expense increased by $4.1 million or 10.5% in 2012 and $1.9 million or 5.1% in 2011. This increase was primarily due to bringing into operations completed projects attributed to the CIP projects in 2012.

Overall, total operating expenses increased by $38.4 million to $967.9 million or 4.2% in 2012 and by $15.0 million to $929.5 million or 1.6% in 2011

Overall, nonoperating revenue (expense) of $294.5 million decreased by $5.4 million or 1.8% from 2011. Nonoperating revenue 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), and BABs subsidy payments.

In 2012, property taxes were levied to support maintenance and operations (M&O) and debt service (DS). Overall property taxes decreased by $2.6 million to $280.7 million compared to the 2011 taxes of $283.3 million. Of the $280.7 million, $238.3 million was to support maintenance and operations. The remaining $42.3 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, and 2010. In 2011, $240.7 million in tax revenue was used to support maintenance and operations and $42.7 million was used to fund debt service

Capital Assets

During fiscal years 2012 and 2011, the System invested by $362.8 million and $241.0 million, respectively, in a broad range of capital assets. Table 5 presents an analysis of capital asset balances between 2010, 2011, and 2012:

TABLE 5
Capital Assets
(In Thousands)

	December 31		
	2012	**2011**	**2010**
Land and land improvements	**$ 18,199**	$ 16,492	$ 9,578
Building and leasehold improvements	**379,412**	330,471	303,759
Equipment	**240,057**	219,436	278,828
	637,668	566,399	592,165
Less accumulated depreciation	**(345,452)**	(304,001)	(377,133)
Construction-in-progress	**596,428**	306,793	151,190
Net capital assets	**$ 888,644**	$ 569,191	$ 366,222

Construction-in-progress increased by $289.6 million in 2012 due to the implementation of the CIP including capitalized interest, architectural and engineering costs, construction costs of the west parking garage and clinical services building. Other capital assets increased $29.8 million given management’s ongoing focus on replacing and upgrading existing equipment and facilities.

In 2012, CIP continued on schedule and within budget. Achievements at the UH Campus included completion of the new 3,300-space parking garage with a new heliport, near completion of the new central utility plant, completion of the structural work for the trauma tower, and commencement of planned renovations. Achievements at the Robert B. Green Campus included completion of the new Clinical Services and Pharmacy Buildings and grand opening on January 14, 2013. The primary source of the funding for the CIP projects was from bond proceeds.

Credit Rating

During 2011, the System was reviewed by Fitch Ratings who affirmed the AAA rating obtained in 2010. Moody's Investor Services, Inc. remained the same at Aa1, and Standard & Poor's Ratings Services remained the same at AA+.

Economic Factors and Next Year's Budget

The System's Board and management established the strategic foundation for success over the next three to five years by implementing a strategy referred to as the "Triple Aim plus". The objectives of this strategy are to: improve the patient experience; improve efficiency through cost and revenue management; improve quality and outcomes; and improve access across the continuum of care.

New Challenges

The System serves as the Anchor facility under the Waiver for RHP 6 which is comprised of twenty counties. A RHP plan was developed to understand and address health care needs in 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 DSRIP plan was submitted timely and it serves as a blueprint 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:

- Impacts of the Waiver which could have a material impact on the System's funding for providing indigent care and for funding initiatives to transform the delivery of care to its patients.
- The System's adoption of lean methodologies to improve efficiencies and reduce outcome variations
- Impacts on the 83rd Texas Legislative Session
- A successful move to the new hospital tower with minimal disruption to patient care and improved standardized care models
- Impact of the Patient Protection and Affordable Care Act, the DSH program and other federal legislation
- The continuity of pediatric care in the community
- The growth of population in the System's service area as well as growth in the number of working poor and medically indigent
- Shortages of healthcare professionals including physicians, physician assistants, nurse practitioners, nurses, therapists and information technology professionals
- Continuing advances in computing and medical technology as well as advances in therapies and pharmaceuticals

- Impact of sequestration cuts based on the Budget Control Act of 2011 which take effect April 1, 2013.

The 2013 Operating and Capital Budget all is about transformation. The 2013 Budget was approached to position the Health System strategically to take advantage of the Waiver. The goal of the Health System is to use the Waiver in support of the Triple Aim *Plus*: to improve customer satisfaction; improve quality and outcomes; improve efficiencies; and improve access to care in light of the anticipated growth in insured lives under the Affordable Care Act (commonly referred to as Health Care Reform. The Health System has included 24 projects in its 2013 Budget that are aimed at meeting the goals of the Waiver program and transforming the care process.

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 University Health System's Financial Offices, 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 Budget and Finance Committee of the Board of Managers acting as 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

Peggy Deming
Executive Vice President /
Chief Financial Officer

University Health System
A Component Unit of Bexar County, Texas

University Health System – Balance Sheets

	December 31	
	2012	**2011**
	(In Thousands)	
Assets		
Current Assets		
Cash and cash equivalents	**$ 139,552**	$ 174,300
Short-term investments	**75,149**	39,294
Patient receivables, less allowance for doubtful accounts (2012 – $294,346; 2011 – $192,830)	**63,444**	62,801
Property taxes receivable	**171,266**	180,452
Estimated amounts due from third-party payers	**72,896**	21,274
Prepaid assets and other current assets	**40,412**	27,993
Total current assets	**562,719**	506,114
Noncurrent Cash and Investments		
Noncurrent investments	**29,527**	25,366
Internally designated for capital acquisitions and improvements	**160,112**	155,503
Internally designated for contingencies	**158,555**	153,399
Held by trustee for professional self-insurance	**4,988**	10,662
Held by trustee for capital acquisition	**277,655**	548,699
	630,837	893,629
Capital Assets, Net	**888,644**	569,191
Other Assets		
Long-term patient receivables, less allowance for doubtful accounts (2012 – $34,330; 2011 – $32,508)	**17,465**	14,238
Other assets	**8,705**	7,149
	26,170	21,387
Total assets	**$ 2,108,370**	$1,990,321

	December 31	
	2012	**2011**
	(In Thousands)	
Liabilities and Net Position		
Current liabilities		
Accounts payable	**$ 78,440**	$ 63,948
Compensated absences	**16,676**	15,789
Estimated third-party payor settlements	**23,807**	18,190
Accrued liabilities	**27,018**	27,735
Medical claims payable	**24,421**	27,327
Deferred tax revenue	**285,003**	280,263
Current maturities of long-term debt	**11,735**	11,485
Total current liabilities	**467,100**	444,737
Long-Term Debt	**720,859**	733,185
Estimated Self-insurance Costs	**7,091**	7,627
Total liabilities	**1,195,050**	1,185,549
Net Position		
Net investment in capital assets	**425,236**	373,221
Restricted expendable	**2,656**	2,009
Unrestricted	**485,428**	429,542
Total net position	**913,320**	804,772
Total liabilities and net position	**$ 2,108,370**	$ 1,990,321

See accompanying notes.

University Health System
A Component Unit of Bexar County, Texas

University Health System – Statements of Revenue, Expenses, and Changes in Net Position

	Year Ended December 31	
	2012	**2011**
	(In Thousands)	
Operating Revenues		
Net patient service revenue, net of provision for bad debts (2012 – $81,711; 2011 – $63,810)	**$ 462,133**	$ 386,160
Premium revenue	**261,717**	265,307
Other revenue	**49,257**	53,944
Total operating revenue	**773,107**	705,411
Operating Expenses		
Employee compensation	**322,880**	309,490
Supplies	**118,907**	113,979
Purchased services	**114,267**	116,728
Medical services	**130,834**	128,590
Medical claims expense	**237,812**	221,652
Depreciation and amortization	**43,220**	39,100
Total operating expenses	**967,920**	929,539
Operating Loss	**(194,813)**	(224,128)
Nonoperating Revenues (Expenses)		
Property taxes	**280,679**	283,324
Investment income	**2,784**	3,204
Proceeds from tobacco settlement	**5,623**	5,639
Build America Bond interest subsidy	**8,946**	8,927
Interest expense	**(3,571)**	(1,254)
Total nonoperating revenues (expenses)	**294,461**	299,840
Excess of revenues over expenses	**99,648**	75,712
Total net position – beginning of year, as previously reported	**804,772**	729,060
Cumulative effect of change in accounting principle *(Note 2)*	**8,900**	-
Total net position – beginning of year, as adjusted	**813,672**	729,060
Total net position – end of year	**$ 913,320**	$ 804,772

See accompanying notes.

University Health System
A Component Unit of Bexar County, Texas

University Health System – Statements of Cash Flows

	Year Ended December 31	
	2012	**2011**
	(In Thousands)	
Operating activities		
Receipts from and on behalf of patients and contractors	**$ 673,974**	$ 652,241
Payments to suppliers	**(600,264)**	(573,236)
Payments to employees	**(322,916)**	(304,708)
Other receipts, net	**45,379**	51,187
Net cash used in operating activities	**(203,827)**	(174,516)
Non-capital financing activities		
Receipt of property taxes	**250,159**	228,771
Proceeds from tobacco settlement	**5,623**	5,639
Net cash provided by non-capital financing activities	**255,782**	234,410
Capital and related financing activities		
Receipt of property taxes for debt service	**44,446**	40,669
Purchase of capital assets, net	**(318,666)**	(197,119)
Repayment of long-term debt	**(11,485)**	(11,960)
Interest on long-term debt	**(39,673)**	(39,781)
Receipt of Build America Bond interest subsidy	**8,954**	8,927
Net cash used in capital and related financing activities	**(316,424)**	(199,264)
Investing activities		
Interest income and realized gains and losses on investments	**2,784**	3,204
Purchases of investments	**(720,143)**	(793,822)
Proceeds from sales of investments	**947,080**	962,347
Net cash provided by investing activities	**229,721**	171,729
Net increase (decrease) in cash and cash equivalents	**(34,748)**	32,359
Cash and cash equivalents, beginning of year	**174,300**	141,941
Cash and cash equivalents, end of year	**$ 139,552**	$ 174,300

University Health System – Statements of Cash Flows (continued)

	Year Ended December 31	
	2012	**2011**
	(In Thousands)	
Reconciliation of operating loss to net cash used in operating activities		
Operating loss	**$ (194,813)**	$ (224,128)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation and amortization expense	**43,220**	39,100
Provision for bad debts	**81,711**	63,810
Changes in operating assets and liabilities:		
Patient receivables	**(85,582)**	(63,145)
Estimated amounts due from and to third-party payers	**(46,005)**	2,282
Accounts payable and accrued expenses	**5,987**	18,108
Other assets and liabilities	**(8,345)**	(10,543)
Net cash used in operating activities	**$ (203,827)**	$ (174,516)

Supplemental Cash Flows Information

Capital assets acquisitions included in accounts payable	**$ 8,469**	$ -

See accompanying notes.

University Health System
A Component Unit of Bexar County, Texas

University Health System Pension Plan – Statements of Plan Net Position

	December 31 2012	December 31 2011
	(In Thousands)	
Assets		
Cash equivalents	**$ 3,125**	$ 2,043
Receivables:		
Accrued income	**358**	333
Accrued employer contributions	**268**	292
Total receivables	**626**	625
Prepaid expenses	**-**	19
Investments:		
Marketable securities:		
Mutual funds – common stocks	**96,418**	81,468
Fixed income securities	**43,613**	39,441
Pooled international equity fund	**28,232**	21,024
Total marketable securities	**168,263**	141,933
Alternative investments:		
Investment in Portfolio Advisors Private Equity Fund VI,L.P.	**10,516**	7,068
Investment in Advisory Research Small Cap Value Equity Fund II, L.P.	**18,560**	15,700
Total alternative investments	**29,076**	22,768
Total investments	**197,339**	164,701
Total assets	**$ 201,090**	$ 167,388
Liabilities		
Accounts payable and accrued expenses	**$ 112**	$ 99
Net position held in trust for pension benefits	**$ 200,978**	$ 167,289

See accompanying notes.

University Health System
A Component Unit of Bexar County, Texas

University Health System Pension Plan –
Statements of Changes in Plan Net Position

	Year Ended December 31 2012	2011
	(In Thousands)	
Additions:		
Contributions:		
Plan Member	**$ 4,608**	$ 4,299
Employer	**16,522**	16,751
	21,130	21,050
Net investment income:		
Interest income	**1,922**	2,005
Dividend income	**2,186**	1,533
Net appreciation (depreciation) in fair value of investments	**18,377**	(4,977)
Investment expense	**(573)**	(553)
	21,912	(1,992)
Total additions	**43,042**	19,058
Deductions:		
Benefit payments	**9,180**	8,442
Administrative expenses	**173**	120
Total deductions	**9,353**	8,562
Changes in net position held in trust for pension benefits	**33,689**	10,496
Net position – beginning of year	**167,289**	156,793
Net position – end of year	**$ 200,978**	$ 167,289

See accompanying notes.

University Health System
A Component Unit of Bexar County, Texas

University Health System Retiree Health Trust – Statements of Plan Net Position

	December 31 2012	2011
	(In Thousands)	
Assets		
Current assets		
Money market	**$ 195**	$ 198
Noncurrent assets		
U.S. government securities	**1,009**	559
Mortgage backed securities	**1,811**	1,707
Corporate bonds	**2,135**	1,850
Mutual funds - equities	**16,746**	12,711
Accrued interest	**40**	34
Total assets	**21,936**	17,059
Liabilities		
Accounts payable and accrued expenses	**4**	3
Net position held in trust for other postemployment benefits	**$ 21,932**	$ 17,056

See accompanying notes.

University Health System
A Component Unit of Bexar County, Texas

University Health System Retiree Health Trust – Statements of Changes in Plan Net Position

	Year Ended December 31	
	2012	**2011**
	(In Thousands)	
Additions:		
Contributions	**$ 2,363**	$ 2,848
Net investment income:		
Interest and dividend income	**563**	442
Net appreciation in fair value of investments	**1,967**	89
Investment expense	**(11)**	(7)
Total additions	**4,882**	3,372
Deductions:		
Administrative expenses	**6**	3
Changes in net position held in trust for other pension benefits	**4,876**	3,369
Net position – beginning of year	**17,056**	13,687
Net position – end of year	**$ 21,932**	$ 17,056

See accompanying notes.

1. Organization

University Health System and Reporting Entity

The Bexar County Hospital District d/b/a University Health 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 is composed of seven members appointed by the Commissioners Court 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 accompanying basic financial statements include the financial statements of Bexar County Hospital District d/b/a University Health System (the System), the University Health System Pension Plan (the Plan), and the University Health System Retiree Health Trust (the OPEB Trust).

The System is the fourth-largest public health system in the state of Texas. Its staff of just over 5,596 health care employees operates University Hospital, San Antonio's only civilian Level 1 Trauma Center; the University Center for Community Health, devoted to the prevention and treatment of diabetes; the University Health Center – Downtown; four University Family Health Centers; University Dialysis – Southeast; South Dialysis; nine preventive health clinics; and a health care program at Bexar County's correctional facilities. Its network of community outpatient and inpatient facilities provides primary care, preventive care, and specialty outpatient care throughout Bexar County. Additionally, the System has had a long-standing affiliation with The University of Texas Health Science Center at San Antonio (UTHSCSA). The System's facilities serve as the major teaching facilities for many of UTHSCSA's health care programs, including the graduate medical education (GME) program. The System is exempt from federal income tax under Section 115(a) of the Internal Revenue Code.

1. Organization (continued)

The System has established various affiliated nonprofit, tax-exempt organizations to facilitate the funding, delivery, and management of its health care mission, as described below.

The University Health System Foundation (the Foundation) (formerly the University Health System Development Corporation) 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 Internal Revenue Code and is a legally separate entity from the System. The Board of Managers of the System appoints a voting majority of the Board of the Foundation, and the Foundation provides services exclusively to the System. The Foundation is included as a blended component unit of University Health System.

Community First Health Plans, Inc. (CFHP) 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 received a notice from the IRS in 2011 that indicated the IRS had automatically revoked its tax-exempt status for failure to file Form 990 in the past 3 years. CFHP does not believe the filing requirement applies to the organization under IRS guidelines. CHFP is working with the IRS to resolve this issue. While there is no guarantee of the outcome of these discussions, CFHP believes it is reasonably possible that the tax-exempt status of CFHP will be retroactively reinstated and that it is appropriate for the organization to continue to operate as a Section 501(c)(4) entity exempt from federal income tax. The Board of Managers of the System appoints a voting majority of the Board of CFHP and CFHP provides services exclusively to the benefit of the System. CFHP is included as a blended component unit of University Health System.

Community First Group Hospital Service Corporation (the PPO) was incorporated in 2001 and licensed by the state of Texas on August 3, 2001, to operate as a group hospital services corporation under Chapter 20 of the Texas Insurance Code. The PPO is a nonprofit, taxable company and is a subsidiary of CFHP. The PPO provides hospital accident coverage and preferred provider organization medical insurance to policyholders through their employer. The services provided by CFHP and its subsidiary, the PPO, benefit the System; therefore, CFHP and its subsidiary are included as a blended component unit of University Health System. In March 2010, the PPO filed a withdrawal plan with the Texas Department of Insurance. The activities of the PPO were not material in 2012 or 2011. The PPO is included as a blended component unit of University Health System.

In June 1996, the System established Community Medicine Associates (CMA), 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.

1. Organization (continued)

CMA was activated by the System on April 1, 2000, to provide primary care physician services at the System's University Family Health Centers. CMA is exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code. The Board of Managers of the System appoints a voting majority of the Board of CMA and CMA provides services exclusively to the benefit of the System. CMA is included as a blended component unit of University Health System.

Management of the System believes the basic financial statements of University Health System presented on a comparative basis to be the most reflective of the System's activities. Patient service revenue and medical claims expense for CFHP members amounting to $11,649,000 and $10,222,000 in 2012 and 2011, respectively, are not eliminated in the basic financial statements. Additionally, other revenue of $1,890,000 and $1,832,000 in 2012 and 2011, respectively, for payments made from the System to CFHP are not eliminated in the basic financial statements. All other significant intercompany accounts and transactions have been eliminated in the basic financial statements.

The basic financial statement presentation also includes the discrete presentation of the Plan. The Plan is a legally separate component unit. It is fiscally dependent on the System and performs services exclusively for employees of the System. A board appointed by the System governs the Plan. Separate financial statements of the Plan are available at the System's administrative offices.

The basic financial statement presentation also includes the discrete presentation of the OPEB Trust. The OPEB Trust is a legally separate component unit. It is fiscally dependent on the System and performs services exclusively for employees of the System. A board appointed by the System governs the OPEB Trust. Separate financial statements of the OPEB Trust are available at the System's administrative offices.

Other Significant Relationships

The System and Vanguard Health System (VHS) (as the successor organization to Baptist Health System) mutually control Texas AirLife, Inc. d/b/a San Antonio AirLife, Inc. (AirLife), a Texas nonprofit corporation, which provides air ambulance services to Bexar County and South Texas. The System and VHS retain control over AirLife through the retention of specific reserve powers, including the appointment of AirLife board members. AirLife is exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code. The System owns a 50% interest in AirLife.

1. Organization (continued)

The System is a member of the Hospital Laundry Cooperative Association (HLCA), an organization established under Chapter 301, Subchapter B of the Texas Health and Safety Code. The System's economic interest in HLCA is determined by "units of interest" under the terms of a Membership Agreement executed by the System on August 17, 1995. HLCA is a taxable cooperative under the Internal Revenue Code. The System owns a 15% interest in HLCA.

The System's ownership in AirLife and HLCA is recorded using the equity method of accounting in the accompanying basic financial statements.

In 1994, UTHSCSA established University Physicians Group (UPG), 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. Effective May 1, 2006, UPG legally changed its name to UT Medicine San Antonio (UT Medicine). UT Medicine serves as a contracting vehicle for physician services with the System and other payors, 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.

2. Significant Accounting Policies

Method of Accounting

The System's basic financial statements are prepared in accordance with Statement No. 34 of the Governmental Accounting Standards Board (GASB), *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, which established standards for external financial reporting for all state and local governmental entities. These standards require presentation of a balance sheet; a statement of revenue, expenses, and changes in net position; and a direct method statement of cash flows. Additionally, Statement No. 34 requires the classification of net position into three components: net investment in capital assets; restricted; and unrestricted. These classifications are defined as follows:

- Net investment in capital assets – This component of net assets consists of capital assets, including restricted capital assets, net of accumulated depreciation and reduced by the outstanding balances of any related borrowings that are attributable to the acquisition, construction, or improvement of those assets.

- Restricted expendable – This component of net position consists of constraints placed on net asset use through external constraints imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments, or constraints imposed by law through constitutional provisions or enabling legislation.

- Unrestricted – This component of net position consists of net position that does not meet the definition of "restricted" or "invested in capital assets, net of related debt."

Additionally, the financial statements of the System are prepared on the accrual basis of accounting, whereby revenues are recognized when earned and expenses are recognized when incurred.

The accompanying basic financial statements also reflect the financial position and changes in financial position of the Plan and the OPEB Trust. 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. 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 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 the OPEB Trust.

2. Significant Accounting Policies (continued)

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.

Statements of Revenue, Expenses, and Changes in Net Position

For purposes of display, transactions deemed by management to be ongoing, major, or central to the provision of health care services are reported as revenue and expenses. Operating revenues include those generated from direct patient care and related support services. Nonoperating revenue consists of those revenues that are related to financing and investing types of activities and result from non-exchange transactions or investment income. When an expense is incurred for purposes for which there are both restricted and unrestricted assets available, it is the System's practice to apply those expenses to restricted assets to the extent such are available, and then to unrestricted assets.

Cash and Cash Equivalents

The System considers all highly liquid investments with original maturities of less than 90 days to be cash equivalents. Cash and cash equivalents at year-end include demand deposits and money market mutual funds. All demand deposits are collateralized with securities held in safekeeping at the Federal Reserve Bank in the name of the System. 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 payors, 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.

2. Significant Accounting Policies (continued)

Supplies Inventory

In 2011 and prior years, the System expensed supplies when purchased rather than when used as the asset value of the supplies inventory was not considered material. In 2012, the System decided to change their accounting policy regarding supply inventories to record an asset for purchased but unused supplies in recognition of the increasing costs of supplies inventory maintained. The impact of the change in accounting policy was to record an increase in other current assets of approximately $8,900,000 and a cumulative effect adjustment to beginning net position. The change in accounting policy did not have a material effect on the 2012 change in net position. The pro forma effects of the change in accounting principle on the 2011 change in net assets is not presented as the amounts are not readily determinable.

Supply inventories are stated at the lower of cost, determined using the first-in, first-out method, or market and are included in prepaid expenses and other current assets.

Deferred Financing Costs

Deferred financing costs represent costs incurred in connection with the issuance of long-term debt. Such costs are being amortized over the term of the respective debt using the straight-line method.

Investments

Investments in U.S. Treasury, agency and instrumentality obligations with a remaining maturity of one year or less at time of acquisition and in nonnegotiable certificates of deposit are carried at amortized cost. The investments in equity investee are reported on the equity method of accounting. All other investments are carried at fair value. Fair value is 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 16. Additionally, in order to comply with various statutory requirements under the Texas Department of Insurance, investments of approximately $66,489,000 and $75,993,000 at December 31, 2012 and 2011, respectively, are held in the name of CFHP.

2. Significant Accounting Policies (continued)

Designated Net Assets

Designated net assets include assets set aside by the Board of Managers for future capital acquisitions and improvements, future contingencies (reserve fund), and assets held by trustees under self-insurance trust arrangements.

Capital Assets and Depreciation

The System records capital assets at cost and provides for depreciation of capital assets by charging against current operations amounts sufficient to amortize the cost of capital assets over their estimated useful lives. The System's policy is to capitalize assets greater than $5,000.

Depreciation is computed using the straight-line method. The System uses American Hospital Association guidelines in establishing useful lives, which generally fall within the following ranges:

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

Expenditures that materially extend useful lives or increase values or capabilities of capital assets are capitalized, whereas routine maintenance, repair, and replacement costs are charged to expense.

The System capitalizes interest costs as a component of construction in progress, based on interest costs of borrowing specifically for the project, net of interest earned on investments acquired with the proceeds of the borrowing.

2. Significant Accounting Policies (continued)

Total interest capitalized and incurred was:

	2012	2011
Total interest expense incurred on borrowings for project	$ 36,024	$ 38,463
Interest income from investment of proceeds of borrowings for project	(1,073)	(2,248)
Net interest cost capitalized	$ 34,951	$ 36,215
Interest capitalized	$ 36,024	$ 38,463
Interest charged to expense	3,571	1,254
Total interest incurred	$ 39,595	$ 39,717

Self-Insurance Cost

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 $175,000 per claim, up to a maximum of $2,000,000 per contract year and $5,000,000 per member lifetime maximum. As of December 31, 2012 and 2011, a reserve of $1,331,000 and $1,349,000, respectively, is recorded in accrued expenses in the balance sheets.

The System funds a revocable self-insurance trust to provide for the payment of medical malpractice and general liabilities. The funding is based on management's recommendations for settlement of claims to limits of $100,000 per claim and $300,000 per occurrence, in accordance with the limited liability provisions of the Texas Tort Claims Act. During 2003, the System began self-insuring "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. As of December 31, 2012 and 2011, a reserve of $1,255,000 and $1,256,000, respectively, is recorded in estimated self-insurance costs in the balance sheets.

2. Significant Accounting Policies (continued)

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 $600,000 up to a maximum limit of $1,000,000 for any one accident or occurrence. As of December 31, 2012 and 2011, a reserve of $6,881,000 and $7,371,000, respectively, is recorded in accrued liabilities and estimated self-insurance costs in the balance sheets.

Net Patient Service Revenue

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors and estimated allowances for uncollectible accounts. The allowances are estimated using historical experience and established billing rates. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

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.

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 2012 and 2011.

2. Significant Accounting Policies (continued)

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. For the period from January 1, 2011 through December 31, 2012, CFHP has reinsurance contracts to cover 90% of certain medical costs in excess of defined deductibles, up to a per-member maximum of $2,000,000 per contract year, and a $5,000,000 per-member lifetime maximum.

Medical claims expense reserves represent the estimated ultimate net cost of all reported and unreported losses incurred through December 31. The reserves for unpaid medical claims expenses are actuarially determined using individual case-basis valuations and statistical analyses. Those estimates are subject to the effects of trends in loss severity and frequency. Although considerable variability is inherent in such estimates, management believes the reserves for medical claims expenses are adequate. The estimates are continually reviewed and adjusted as necessary, as experience develops or new information becomes known. Such adjustments are included in current operations.

Changes in the System's aggregate liability for medical claims during 2012 and 2011 were as follows:

Year Ended December 31	Beginning of Year Liability	Current-Year Claims and Changes in Estimates	Claim Payments	End of Year Liability
		(In Thousands)		
2012	**$ 27,327**	**$ 237,812**	**$ (240,718)**	**$ 24,421**
2011	$ 35,338	$ 221,652	$ (229,663)	$ 27,327

2. Significant Accounting Policies (continued)

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 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, 2012, 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 $490,577,000 and $365,353,000 for the years ended December 31, 2012 and 2011, respectively.

Property Taxes

The Commissioners Court of Bexar County levies for the System an ad valorem tax as provided under state law on properties within the county. These taxes are collected by the Bexar County Tax Assessor-Collector and are remitted to the System when received. The System's tax rate is levied and becomes collectible in October of each year based on the certified assessed value as of the previous January 1. Taxes levied on October 1 are designated to support the System's operations for the following calendar year.

2. Significant Accounting Policies (continued)

The System records the levy, net of an assessment fee and allowance for uncollectible amounts, as a current receivable and deferred tax revenue in the year levied. The deferred tax revenue is accreted to revenue on a straight-line basis in the following year. The System received approximately 26.3% in 2012 and 28.3% in 2011 of its financial support from property taxes.

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 $8,946,000 and $8,927,000 of nonoperating revenue in 2012 and 2011, respectively, for the BABs interest subsidy. Subsequent to December 31, 2012, the BABs subsidy was reduced as part of the federal sequestration spending reductions. This reduction is anticipated to be less than 10%.

Electronic Health Record Incentive

The Electronic Health Records Incentive Program, enacted as part of the American Recovery and Reinvestment Act of 2009, provides for one-time incentive payments under both the Medicare and Medicaid programs to eligible hospitals that demonstrate meaningful use of certified electronic health records technology (EHR). Payments under the Medicare program are generally made for up to four years based on a statutory formula. Payments under the Medicaid program are generally made for up to four years based upon a statutory formula, as determined by the state, which is approved by the Centers for Medicare and Medicaid Services. Payment under both programs are contingent on the hospital continuing to meet escalating meaningful use criteria and any other specific requirements that are applicable for the reporting period. The final amount for any payment year is determined based upon an audit by the fiscal intermediary. Events could occur that would cause the final amounts to differ materially from the initial payments under the program.

The System recognizes revenue ratably over the reporting period starting at the point when management is reasonably assured it will meet all of the meaningful use objectives and any other specific grant requirements applicable for the reporting period.

The System has recorded revenue from both programs of approximately $3,839,000 and $6,003,000 in 2012 and 2011, respectively, which is included in other revenue within operating revenues in the statement of revenues, expenses and changes in net position.

2. Significant Accounting Policies (continued)

Donor-Restricted Funds

Donor-restricted funds are used to differentiate resources, the uses of which are restricted by donors or grantors, from resources or general funds on which donors or grantors place no restrictions or those funds that arise as a result of the operations of the System for its stated purpose. Restricted gifts and other restricted resources are recorded as additions to the appropriate restricted fund.

Resources restricted by donors or grantors for specific operating purposes are reported in other revenue in the period received. At December 31, 2012 and 2011, donor-restricted funds were available for various specific operating activities.

Reclassifications

Certain reclassifications have been made to the 2011 financial statements to conform to the 2012 presentation. The reclassifications had no effect on the changes in net position.

3. Property Taxes

Property Taxes Receivable

Property taxes receivable are composed of the following as of December 31:

	2012	**2011**
	(In Thousands)	
Current taxes, net of allowance for uncollectible amounts of $2,889 in 2012 and $2,838 in 2011	**$ 157,467**	$ 165,845
Delinquent taxes, net of allowance for uncollectible amounts of $4,346 in 2012 and $4,069 in 2011	**8,975**	9,598
Penalty and interest, net of allowance for uncollectible amounts of $5,045 in 2011 and $4,703 in 2011	**4,824**	5,009
	$ 171,266	$ 180,452

Property Taxes Revenue

As indicated in Note 2, the Bexar County Commissioners Court levies an ad valorem tax on the value of property in Bexar County to support the provision of care to indigent residents of Bexar County. In 2012 and 2011, the Commissioners Court levied a tax rate for maintenance and operations (M&O) and debt service (DS) to support the System’s operations and long-term debt, described in Note 7.

3. Property Taxes (continued)

The System received approximately 26.3% in 2012 and 28.3% in 2011 of its financial support from property taxes. The revenues received for 2012 and 2011 were classified as follows:

	2012	2011
	(In Thousands)	
Maintenance and operations	**$ 238,334**	$ 240,655
Debt service	**42,345**	42,669
	$ 280,679	$ 283,324

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:

	2012	2011
	(In Thousands)	
Medicare	**$ 16,913**	$ 22,602
Medicaid	**22,936**	31,098
Other third-party payers	**25,536**	41,743
Patients	**344,200**	206,934
	409,585	302,377
Less allowance for uncollectible accounts	**(328,676)**	(225,338)
	$ 80,909	$ 77,039

5. Property, Plant, and Equipment

The System's investment in property, plant, and equipment consists of the following:

	January 1, 2012	**Additions/ Transfers**	**Retirements**	**December 31, 2012**
		(In Thousands)		
Capital assets:				
Land and land improvements	**$ 16,492**	**$ 3,411**	**$ (1,704)**	**$ 18,199**
Buildings and improvements	**330,471**	**48,941**	**-**	**379,412**
Equipment	**219,436**	**20,782**	**(161)**	**240,057**
Total at historical cost	**566,399**	**73,134**	**(1,865)**	**637,668**
Less:				
Accumulated depreciation – buildings, building improvements and land improvements	**(153,743)**	**(18,958)**	**1,510**	**(171,191)**
Accumulated depreciation – equipment	**(150,258)**	**(24,164)**	**161**	**(174,261)**
Total accumulated depreciation	**(304,001)**	**(43,122)**	**1,671**	**(345,452)**
Construction-in-progress	**306,793**	**289,635**	**-**	**596,428**
Total capital assets, net of accumulated depreciation	**$ 569,191**	**$ 319,647**	**$ (194)**	**$ 888,644**

	January 1, 2011	Additions/ Transfers	Retirements	December 31, 2011
		(In Thousands)		
Capital assets:				
Land and land improvements	$ 9,578	$ 8,568	$ (1,654)	$ 16,492
Buildings and improvements	303,759	48,581	(21,869)	330,471
Equipment	278,828	28,219	(87,611)	219,436
Total at historical cost	592,165	85,368	(111,134)	566,399
Less:				
Accumulated depreciation – buildings, building improvements and land improvements	(161,987)	(15,264)	23,508	(153,743)
Accumulated depreciation – equipment	(215,146)	(22,693)	87,581	(150,258)
Total accumulated depreciation	(377,133)	(37,957)	111,089	(304,001)
Construction-in-progress	151,190	155,603	-	306,793
Total capital assets, net of accumulated depreciation	$ 366,222	$ 203,014	$ (45)	$ 569,191

As of December 31, 2012 and 2011, included in construction-in-progress is capitalized interest of $112,707,000 and $85,960,000, respectively.

6. Leases

Rental expense pursuant to noncancelable operating leases amounted to $8,089,000 and $6,520,000 for the years ended December 31, 2012 and 2011, respectively. Future minimum annual lease obligations relating to noncancelable leasing arrangements are as follows (in thousands):

2013	$ 4,933
2014	3,589
2015	1,380
2016	1,050
2017	886
2018 and thereafter	929
Total	$ 12,767

7. Long-Term Debt

A schedule of changes in the System's long-term debt for 2012 and 2011 follows:

	Balance at January 1, 2012	Additions	Reductions	Balance at December 31, 2012	Amounts Due Within One Year
			(In Thousands)		
Bonds payable:					
Certificates of Obligation, series 2008, net	**$ 266,764**	**$ -**	**$ 4,323**	**$ 262,441**	**$ 2,815**
Certificates of Obligation, series 2009A, net	**30,670**	**-**	**1,337**	**29,333**	**4,355**
Certificates of Obligation, series 2009B, net	**246,395**	**-**	**-**	**246,395**	**-**
Certificates of Obligation, series 2010B, net	**200,840**	**-**	**6,415**	**194,425**	**4,565**
Total long-term debt	**$ 744,669**	**$ 0**	**$ 12,075**	**$ 732,594**	**$ 11,735**

The outstanding principal balances shown above are net of a net bond discount at December 31, 2012 of approximately $756,000 and reductions in the principal balance include amortization of the net bond discount of $590,000.

7. Long-Term Debt (continued)

	Balance at January 1, 2011	Additions	Reductions	Balance at December 31, 2011	Amounts Due Within One Year
			(In Thousands)		
Bonds payable:					
Certificates of Obligation, series 2008, net	$ 271,741	$ -	$ 4,977	$ 266,764	$ 4,120
Certificates of Obligation, series 2009A, net	34,178	-	3,508	30,670	950
Certificates of Obligation, series 2009B, net	246,395	-	-	246,395	-
Certificates of Obligation, series 2010B, net	204,885	-	4,045	200,840	6,415
Total long-term debt	$ 757,199	$ 0	$ 12,530	$ 744,669	$ 11,485

The outstanding principal balances shown above are net of a net bond discount at December 31, 2011 of approximately $165,000 and reductions in the principal balance include amortization of the net bond discount of $570,000.

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. All of the 2008 Certificates still outstanding may be redeemed at the System's option on or after February 15, 2018 at a price of par plus accrued interest at the date of redemption.

The tax Certificates of Obligation, series 2009A (the 2009A Certificates) were issued in 2009, and mature in various amounts annually on February 15, from 2010 through 2017, with stated coupon rates ranging from 1.00% to 5.00%. 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 2009A and 2009B Certificates are collateralized by a levy of ad valorem tax revenue. All of the 2009A and 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.

7. Long-Term Debt (continued)

The tax Certificates of Obligations, 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.

Unexpended proceeds of debt are maintained in Project Funds for each individual issuance until expended for their designated purpose, and as required by the terms of each issuance. DS ad valorem tax receipts levied annually by the Commissioners Court are maintained in a Certificate Fund account collectively for all issuances. The 2010B Certificates may be redeemed on various dates prior to the scheduled maturities at a price of par plus accrued interest at the date of redemption.

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

	Principal	Interest	Interest Credit (BABs)*	Net Interest
Year ending December 31:				
2013	$ 11,735	$ 39,400	$ (8,933)	$ 30,467
2014	12,495	39,043	(8,913)	30,130
2015	13,560	38,600	(8,894)	29,706
2016	14,940	38,064	(8,874)	29,190
2017	16,435	37,425	(8,845)	28,580
2018–2022	101,975	174,054	(41,636)	132,418
2023–2027	126,110	144,930	(34,970)	109,960
2028–2032	156,765	104,915	(25,610)	79,305
2033–2037	195,785	54,122	(13,839)	40,283
2038–2040	83,550	5,432	(1,744)	3,688
Total	$ 733,350	$ 675,985	$ (162,258)	$ 513,727

*Interest credit amount does not reflect impact of reductions from sequestration discussed in Note 2.

8. Net Patient Service Revenue

The System provides services under contract to patients covered under the Medicare and Medicaid programs. The System is generally reimbursed at prospectively determined rates based upon diagnosis, plus certain adjustments and under a cost reimbursement methodology for certain other services. Net revenues from these programs are included in patient service revenues at net amounts reflecting customary charges reduced to estimated reimbursement payments and represented approximately 39% and 42% of patient service revenue for the years ended December 31, 2012 and 2011, respectively. The amounts due to or from these programs are subject to final review and settlement by the respective program's fiscal intermediary. Currently, the System's statements of reimbursable cost have been audited by and settled with the fiscal intermediary through 2007 for Medicare and Medicaid.

At December 31, 2012 and 2011, the System estimated net amounts due to the programs of $23,807,000 and $18,190,000, respectively. Included in net patient service revenue is an increase of $2,066,000 and $2,600,000 for the years ended December 31, 2012 and 2011, respectively, to adjust balances previously estimated as a result of final and tentative settlements and for years that are no longer subject to audits, reviews, or investigations.

The System has also entered into payment agreements with certain commercial insurance carriers, employers, and other third-party administrators. The basis for payment to the System under these arrangements includes prospectively determined daily or per-stay rates and discounts from established charges. Total discounts were $754,726,000 and $601,263,000 for the years ended December 31, 2012 and 2011, respectively.

9. Disproportionate Share Revenue

During 1991, the Texas Legislature issued Senate Bill 82, levying an assessment against certain hospitals and hospital systems. The funds collected via this assessment are pooled by the state in order to receive federal matching funds under the Medicaid Disproportionate Share Program. The state then allocates the federal monies received to hospitals and hospital systems that serve a large disproportionate volume of Medicaid and uninsured patients, the purpose being to increase access to health care for Texas' indigent patients. The amounts received under this program were $15,400,000 and $16,181,000 for 2012 and 2011, respectively, and are included in net patient service revenue. The amounts receivable included in estimated amounts due from third-party payers at December 31, 2012 and 2011, were $3,937,000 and $3,498,000, respectively.

10. Upper Payment Limit (UPL)

In May 2002, the federal government approved the Upper Payment Limit (UPL) program for the state of Texas, with an effective date of August 31, 2001. The UPL program is a state program that uses federal matching funds to raise state Medicaid reimbursement rates to 100% of equivalent Medicare rates for certain public hospital systems.

The amounts received under the UPL program were $93,103,000 and $69,198,000 for 2012 and 2011, respectively, and are included in net patient service revenue. The funding historically received through the UPL program is largely being replaced by the program discussed in Note 11. The amounts receivable included in estimated amounts due from third-party payers at December 31, 2012 and 2011, were $53,420,000 and $15,426,000, respectively. The significant increase noted in 2012 was due to increases in uncompensated care and Medicaid patients coupled with fluctuations in various other factors impacting the amount of revenue the System is eligible to receive under the program discussed in Note 11.

11. The Waiver

On December 12, 2011, Texas received approval from the Centers for Medicare & Medicaid Services (CMS) for the Texas Health Care Transformation and Quality Improvement Program (the Waiver) that allows 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 became effective on October 1, 2011 and will extend through September 30, 2016. Transition payments were made in the first waiver year that ended September 30, 2012, to hospitals and physicians based on supplemental UPL payments they received in 2011. In years 2 through 5, the Waiver replaces the UPL program with two pools, an Uncompensated Care (UC) pool to offset the cost of uncompensated care and a *Delivery System Reform Initiative Payment* (DSRIP) pool 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 will be 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 2012 UPL payments of $93,103,000 discussed in Note 10 were transition payments under the UC pool.

11. The Waiver (continued)

The development of an RHP plan was the basis for the full DSRIP year 1 payment allocation. RHP 6 submitted its RHP plan to the Texas Department of Health and Human Services in December 2012 and the RHP plan was submitted to CMS in March 2013. The System has recognized DSRIP revenue of $11,649,000 in 2012 which is recorded as receivable in estimated amounts due from third-party payers in the balance sheet. The System expects to receive the DSRIP year 1 payment in the second quarter of 2013.

12. Tobacco Settlement

The System receives revenue that is the result of a settlement between various counties and hospital districts in Texas and the tobacco industry from tobacco-related health care costs. Allocations of the tobacco settlement to the System were $5,623,000 in 2012 and $5,639,000 in 2011, and are included in nonoperating revenue.

13. Affiliation Agreement

The System and UTHSCSA entered into a 20-year agreement in 1992 that provides that the System will be available to UTHSCSA for teaching and research. Under the agreement and other sub-agreements, UTHSCSA supervises and directs professional services to patients of the System. The System recorded expenses of approximately $13,356,000 and $14,244,000 in 2012 and 2011, respectively, under the terms of the agreements.

14. Pension Plan and Other Postretirement Benefits

The Plan is a single-employer defined benefit pension plan covering substantially all of the System's employees who work at least 20 hours per week or at least 1,000 hours annually and have hire dates through June 30, 2012. Employer contributions to the Plan amounted to $15,420,000 and $15,688,000 for the years ended December 31, 2012 and 2011, respectively.

Benefits

Participants are eligible for normal retirement benefits after attaining the age of 65 and completing five years of vesting service, or after the age of 55 when years of service plus age are equal to 85 (Rule of 85). Annual normal retirement benefits are equal to 1.5% of the average of participants' five highest consecutive years' pay times the number of years of credited service. The Plan's audited financial statements are available at the System's offices in San Antonio, Texas.

14. Pension Plan and Other Postretirement Benefits (continued)

At January 1, 2012, the date of the most recent actuarial valuation, Plan membership consisted of:

Inactive participants:	
Retirees and beneficiaries currently receiving benefits	659
Terminated employees with deferred benefits	1,069
Total inactive participants	1,728
Active participants:	
Fully vested	2,927
Nonvested	1,254
Total active participants	4,181
Total participants	5,909

Annual Pension Cost and Net Pension Obligation

For fiscal year 2012 and 2011, the System's annual pension cost and contribution was $15,420,000 and $15,688,000, respectively, resulting in no net pension obligation.

Fiscal Year Ended	**Annual Pension Cost (APC)**	**Percentage of APC Contributed**	**Net Pension Obligation**
	(In Thousands)		
December 31, 2012	$15,420	100%	–
December 31, 2011	$15,688	100%	–
December 31, 2010	$13,111	100%	–

The January 1, 2012, 2011, and 2010 pension benefit obligations were determined as a part of actuarial valuations using the projected unit cost method. Significant actuarial assumptions used include: (a) a rate of return on the investment of present and future assets of 7.5% per year compounded annually, (b) projected salary increases of 5.5% per year compounded annually, and (c) an inflation rate of 3.5%.

14. Pension Plan and Other Postretirement Benefits (continued)

Contributions Required

The System makes contributions that are actuarially determined to pay the Plan's normal cost plus amortization of any unfunded liability. The System amortizes the Plan's unfunded liability over a period of 30 years, and is determined, in part, based on the System's level of contributions. The System's normal cost was approximately $10,470,000, $10,770,000, and $10,607,000 in 2012, 2011, and 2010, respectively, which was 4.79%, 4.82% and 4.68% of covered payroll for 2012, 2011 and 2010, respectively. The annual covered payroll for 2012, 2011, and 2010, was approximately $218,571,000, $223,279,000, and $234,739,000, respectively. Participants are required to contribute 2.00% of annual compensation to the Plan. The System made contributions of $15,420,000, $15,688,000, and $13,111,000, in 2012, 2011, and 2010, respectively. The costs of administering the Plan are paid by the Plan and are considered in the determination of the employer contribution rate.

Other Postretirement Benefits

Description

In 2007, the System adopted GASB Statement No. 45 (GASB 45), *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions (OPEB).* This statement establishes standards for the measurement, recognition, and display of OPEB expense/expenditures and related liabilities footnote disclosures. During 2007, the System approved the OPEB Trust to receive contributions and accumulate assets to fund the cost of retiree medical benefits in accordance with the adoption of GASB 45 as a single-employer defined benefit health care plan. Employees eligible to retire from the System may elect to continue medical benefits, currently at the same contribution rates and schedule of benefits as active employees. The financial statements of the OPEB Trust are included as a discretely presented component unit of the System.

Funding Policy

The contribution requirements of plan members and the System are established and may be amended by the Investment Committee of the OPEB Trust. The required contribution is based on projected pay-as-you-go financing requirements. For fiscal year 2012, the System contributed $2,363,000 to the OPEB Trust, which is inclusive of plan member contributions. Plan members receiving benefits contributed $634,000 through their required contribution of $97.43 per month for retiree-only coverage, $185.12 for retiree and spouse coverage, $182.19 for retiree and children coverage, and $341.98 for retiree and family coverage.

14. Pension Plan and Other Postretirement Benefits (continued)

The cost of administering the OPEB Trust are paid by the OPEB Trust and are considered in the determination of the employer contribution rate.

Annual OPEB Cost and Net OPEB Obligation

The System's annual OPEB cost is calculated based on the annual required contribution (ARC) of the employer, an amount actuarially determined in accordance with the parameters of GASB 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.

The following table shows the components of the System's annual OPEB cost for the years 2012 and 2011, the amount actually contributed to the OPEB Trust, and changes in the System's net OPEB obligation to the OPEB Trust:

	Year Ended December 31, 2012	Year Ended December 31, 2011
	(In Thousands)	
Annual required contribution	$3,772	$3,763
Interest on net OPEB obligation	-	-
Adjustment to annual required contribution	(924)	(1,400)
Annual OPEB cost (expense)	2,848	2,363
Contributions made	(2,848)	(2,363)
Change in net OPEB obligation	-	-
Net OPEB obligation – beginning of year	-	-
Net OPEB obligation – end of year	$ -	$ -

14. Pension and Other Postretirement Benefits (continued)

The System's annual OPEB cost, the percentage of annual OPEB cost contributed to the OPEB Trust, and the net OPEB obligation for 2012, 2011 and 2010 are as follows:

Fiscal Year Ended	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
		(In Thousands)	
December 31, 2012	**$ 3,763**	**100%**	**$ -**
December 31, 2011	$ 3,772	100%	$ -
December 31, 2010	$ 3,782	100%	$ -

Funded Status and Funding Progress

As of January 1, 2012, the most recent actuarial valuation date, the actuarial accrued liability for benefits was approximately $28,074,000, and the actuarial value of assets was $17,927,000, resulting in an unfunded actuarial accrued liability (UAAL) of approximately $10,147,000. The actuarial value of assets as a percentage of the actuarial accrued liability, or funded ratio, was 63.9%.

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 basic 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.

14. Pension and Other Postretirement Benefits (continued)

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 up to that point. The actuarial methods and assumptions used include techniques that are 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, 2012 actuarial valuation, the entry age actuarial cost method was used. The actuarial assumptions included a 7.5% investment rate of return and an annual health care cost trend and inflation rate of 5%. 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. The amortization period at December 31, 2012, was 30 years.

15. Commitments and Contingencies

The System's Board has approved various facility improvements and renovation projects. As of December 31, 2012, the System had outstanding contractual arrangements totaling $9,977,000 for architectural and construction services, excluding the project below.

As described in Note 7, the System issued long-term debt in previous years to fund the construction of capital projects at two of the System's locations. In connection with the construction program, the System entered into agreements for design, program management, and construction of those projects. The System had outstanding contracts totaling $278,922,000 at December 31, 2012.

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, workers compensation and employee health claims. Settled claims have not exceeded this commercial coverage in any of the three preceding years.

15. Commitments and Contingencies (continued)

At December 31, 2012 and 2011, the System was a defendant in certain pending civil litigation, and the System has notice of certain claims that have been asserted against it. In addition, unasserted claims may exist for known and unknown incidents. The System covers its exposure for asserted and unasserted claims through a program of self-insurance. The System has accrued its best estimate of these contingent losses. The reserves for these contingent losses include estimates of the ultimate cost for both reported claims and claims incurred but not yet reported. In addition, the System has established a reserve in the amount of $1,200,000 that includes potential System exposure for medical malpractice claims arising from a limited number of System-employed physicians. The reserve will provide "tail coverage" for a physician's medical malpractice claim occurring prior to October 1, 2003, the period when such physicians were covered under a "claims made" medical malpractice policy.

The System also self-insures workers' compensation claims. The System has purchased reinsurance for individual claims exceeding $600,000 up to a maximum limit of $1,000,000 for any one accident or occurrence. The amounts provided for funding and the estimated liability are based on claims made and claims incurred but not yet reported. During the years ended December 31, 2012 and 2011, the System recognized expense of $2,491,000 and $2,012,000, respectively, associated with the workers' compensation program.

In 2006, the System affiliated with Bexar County's largest providers of health care services to the poor and indigent in a program called Bexar Regional Upper Payment Limit Program (Bexar Regional UPL Program). The program was approved by the Centers for Medicare & Medicare Services (CMS) in July 2006 and further reviewed and approved in April 2008. Through participation in the program, the affiliated hospitals increased the medical care and other services they provide to the poor and indigent. Some of these services are provided in System facilities.

As a result of participating in the Bexar Regional UPL Program, the System has realized benefits of lower medical service costs amounting to $87,055,000 and $85,264,000 in 2012 and 2011, respectively. The System also incurred increased costs to supplement the state's funding for the affiliated providers in the amounts of $57,175,000 and $58,359,000 in 2012 and 2011, 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.

16. Investment Risk

The disclosures required under GASB Statement No. 40 (GASB 40), *Deposit and Investment Risk Disclosures,* for University Health System are reflected below. Separate financial statements of the Plan include applicable investment disclosures.

(A) Credit Risk and Concentration of 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, its affiliated nonprofit health maintenance organization (HMO), 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 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.

16. Investment Risk (continued)

Per GASB 40, unless there is information to the contrary, obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk and do not require disclosure of credit quality. GASB 40 also provides that securities with split ratings, or a different rating assignment between NRSROs, are disclosed using the rating indicative of the greatest degree of risk.

The following table presents each applicable investment type grouped by rating as of December 31, 2012:

Investment Type *(In Thousands)*	2012	2011	Rating
U.S. government, Treasury	**$ 59,744**	$ 40,216	Exempt from
U.S. government, Treasury strips	**1,700**	1,698	disclosure
Total U.S. government, guaranteed	**61,444**	41,914	
U.S. government, non-guaranteed:			
Federal Home Loan Bank notes	**247,172**	410,476	AA+
Federal National Mortgage Association notes	**208,784**	177,334	AA+
Federal Farm Credit Bank notes	**80,182**	125,204	AA+
Total U.S. government, non-guaranteed	**536,138**	713,014	
Money market mutual funds	**222,670**	348,233	AAAm
External investment pool	**4,068**	4,062	AAAm
Total	**$ 824,320**	$ 1,107,223	

In accordance with the System's investment policy, the System has no limit on the amount of investments with a single authorized issuer, other than a 15% limit on repurchase agreements with a single issuer. As of December 31, 2012, the System was in compliance with this policy. According to GASB 40, concentration of credit risk is defined as more than 5% of the market value of the total portfolio invested in securities issued by one issuer. Investments with an explicit guarantee by the U.S. government are exempt from the disclosure requirement.

The System maintained no investments in derivatives at December 31, 2012 and 2011.

16. Investment Risk (continued)

(B) Custodial Credit Risk

Custodial credit risk for deposits is the risk that, in the event of failure of a depository financial institution, the System will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, the System will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The System's policy does not contain specific requirements to limit its exposure to custodial credit risk for deposits or investments. As of December 31, 2012, all investments are registered in the System's name.

(C) Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair market value to changes in market interest rates. Interest rate risk inherent in the portfolio is measured by monitoring the segmented time distribution of the investments in the portfolio. The System's investment policy limits the maturity periods of its investments by type to a maximum of ten years.

The tables below summarizes the System's segmented time distribution investment maturities in years by investment type as of December 31, 2012 and 2011.

		Years		
	Fair Value	**< 1**	**1 to 5**	**6 to 10**
		(In Thousands)		
2012				
Money market mutual funds	$ 222,670	$ 222,670	$ -	$ -
U.S. government, Treasury	59,744	55,940	3,804	-
U.S. government, Treasury strips	1,700	1,700	-	
U.S. government, Federal Farm Credit Bank notes	80,182	73,670	6,512	-
U.S. government, Federal Home Loan Bank notes and Federal National Mortgage Association notes	455,956	282,921	172,450	585
External Investment Pool	4,068	4,068	-	-
Total	$ 824,320	$ 640,969	$ 182,766	$ 585

16. Investment Risk (continued)

		Years		
	Fair Value	**< 1**	**1 to 5**	**6 to 10**
		(In Thousands)		
2011				
Money market mutual funds	$ 348,233	$ 348,233	$ -	$ -
U.S. government, Treasury	40,216	33,256	5,849	1,111
U.S. government, Treasury strips	1,698	1,698	-	
U.S. government, Federal Farm Credit Bank notes	125,204	62,389	62,226	589
U.S. government, Federal Home Loan Bank notes and Federal National Mortgage Association notes	587,810	353,237	234,001	572
External Investment Pool	4,062	4,062	-	-
Total	$ 1,107,223	$ 802,875	$ 302,076	$ 2,272

(D) Reconciliation of Deposits and Investments to Balance Sheet Presentation

The carrying value of deposits and investments are included in the balance sheets as follows:

	2012	**2011**
	(In Thousands)	
Carrying value		
Deposits	**$ 21,218**	$ -
Investments	**824,320**	1,107,223
	$ 845,538	$ 1,107,223
Included in the following balance sheet captions		
Cash and cash equivalents	**$ 139,552**	$ 174,300
Short-term investments	**75,149**	39,294
Noncurrent investments	**29,527**	25,366
Internally designated for capital acquisition and improvements	**160,112**	155,503
Internally designated for contingencies	**158,555**	153,399
Held by trustee for professional self-insurance	**4,988**	10,662
Held by trustee for capital acquisition	**277,655**	548,699
	$ 845,538	$ 1,107,223

17: Patient Protection and Affordable Care Act

The Patient Protection and Affordable Care Act (PPACA) will substantially reform the United States health care system. The legislation impacts multiple aspects of the health care system, including many provisions that change payments from Medicare, Medicaid and insurance companies. Starting in 2014, the legislation requires the establishment of health insurance exchanges, which will provide individuals without employer-provided health care coverage the opportunity to purchase insurance. It is anticipated that some employers currently offering insurance to employees will opt to have employees seek insurance coverage through the insurance exchanges. It is possible the reimbursement rates paid by insurers participating in the insurance exchanges may be substantially different than rates paid under current health insurance products. Another significant component of the PPACA is the expansion of the Medicaid program to a wide range of newly eligible individuals.

In anticipation of this expansion, payments under certain existing programs, such as Medicare disproportionate share, will be substantially decreased. Each state's participation in an expanded Medicaid program is optional. The state of Texas has currently indicated it will not expand the Medicaid program, which may result in revenues from newly covered individuals not offsetting the System's reduced revenue from other Medicare/Medicaid programs.

The PPACA is extremely complex and may be difficult for the federal government and each state to implement. While the overall impact of the PPACA cannot currently be estimated, it is possible that it will have a negative impact on the System's net patient service revenue. Additionally, it is possible the System will experience payment delays and other operational challenges during PPACA's implementation.

18: Future Change in Accounting Principle

The GASB has issued Statement No. 65, Items Previously Reported as Assets and Liabilities (GASB 65), which reclassifies certain items that were previously reported as assets and liabilities as deferred outflows resources, deferred inflows of resources or current-period outflows and inflows. Deferred inflows and deferred outflows are reported in the balance sheet and they result from outflows and inflows of resources that have already taken place but are not recognized in the financial statements as revenues and expenses/expenditures because they relate to a future period. The System expects to first apply GASB 65 in the year ending December 31, 2013, using a retrospective application method. The impact of applying the statement has not been determined.

Required Supplementary Information

University Health System
A Component Unit of Bexar County, Texas

Schedule of Funding Progress –
University Health System Retiree Health Trust
(In Thousands)

Actuarial Valuation Date	**Actuarial Value of Assets**	**Actuarial Accrued Liability (AAL)**	**Plan Assets Less than AAL**	**Funded Ratio**
January 1, 2012	**$ 17,927**	**$ 28,074**	**$ 10,147**	**63.9%**
January 1, 2011	$ 14,031	$ 35,123	$ 21,092	40.0%
January 1, 2010	$ 10,072	$ 33,227	$ 23,155	30.4%

University Health System
A Component Unit of Bexar County, Texas

Schedule of Funding Progress –
University Health System Pension Plan
(In Thousands)

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL)	Plan Assets Less than AAL	Funded Ratio	Covered Payroll	Plan Assets Less Than AAL as a Percent of Covered Payroll
January 1, 2012	**$ 183,350**	**$ 258,253**	**$ (74,903)**	**71.0%**	**$218,571**	**(34.3%)**
January 1, 2011	$ 164,279	$ 238,558	$ (74,279)	69.0%	$223,279	(33.3%)
January 1, 2010	$ 147,064	$ 224,485	$ (74,421)	65.6%	$234,739	(31.7%)

Other Financial Information

University Health System
A Component Unit of Bexar County, Texas

Schedule of Expenditures of Federal and State Awards

Year Ended December 31, 2012

Federal Grantor/Pass-Through Grantor/Program Title	Federal CFDA Number	Pass-Through Entity Identifying Number	Expenditures
Federal Programs			
U.S. Department of Health and Human Services			
Direct awards:			
Family Planning Service Delivery Improvement Research Grants:			
UHS Male Health Program	93.974		$147,341
UHS Male Health Program	93.974		37,882
			$185,223
Total Direct Awards			**$185,223**
Indirect awards:			
Passed Through the Department of State Health Services			
Centers for Disease Control and Prevention Investigations and Technical Assistance			
Breast and Cervical Cancer	93.283		$125,074
Breast and Cervical Cancer	93.283		19,919
Breast and Cervical Cancer	93.283		50,785
			$195,778
HIV Prevention Activities Health Department Based			
HIV Rapid Testing to Clients Assessing Emergency Services	93.940		$113,966
Refugee and Entrant Assistance State Administered Programs			
Refugee Program	93.566		$678,030
Refugee Program	93.566		305,024
			$983,054
Refugee and Entrant Assistance Discretionary Grants			
Refugee Program	93.576		$3,990

University Health System
A Component Unit of Bexar County, Texas

Schedule of Expenditures of Federal and State Awards (continued)

Federal Grantor/Pass-Through Grantor/Program Title	Federal CFDA Number	Pass-Through Entity Identifying Number	Expenditures
Federal programs (continued)			
Maternal and Child Care Health Services Block Grant to the States:			
Title V Child	93.994		$24,767
Title V Child	93.994		2,285
Title V Prenatal	93.994		15,316
Title V Prenatal	93.994		2,124
			$44,492
Family Planning Services:			
Title X Family Planning	93.217		$22,075
Medical Assistance Programs:			
Title XIX Family Planning	93.778		$242,861
Social Services Block Grant:			
Title XX Family Planning	93.667		$4
Family Planning	93.667		503,365
			$503,369
Passed Through Bexar County:		74-1557491	
HIV Emergency Relief Project Grants			
Part A	93.914		$273,116
Part A	93.914		1,247,659
			$1,520,775
HIV Care Formula Grants			
Part B (Service Delivery)	93.917		$327,147
Part B (Service Delivery)	93.917		127,296
Part B (State Services)	93.917		193,505
Part B (State Services)	93.917		133,443
			$781,931
Passed Through the University of Texas Health Science Center SA:		74-1586031	
Coordinated Services and Access to Research for Women, Infants, Children, and Youth:			
South Texas Family AIDS Network (Part D)	93.153		$331,915
South Texas Family AIDS Network (Part D)	93.153		219,762
			$551,677

University Health System
A Component Unit of Bexar County, Texas

Schedule of Expenditures of Federal and State Awards (continued)

Federal programs (continued)

Special Projects of National Significance:		
Women's HIV Entry, Access, and Retention in Treatment Initiative	93.928	$48,614
Women's HIV Entry, Access, and Retention in Treatment Initiative	93.928	19,295
		$67,909
Teenage Pregnancy Prevention Program:		
UTHSCSA Sex Education Program		$74,000
Passed Through the City of San Antonio:		
Head Start	93.600	$20,596
Head Start	93.600	134,399
		$154,995
Affordable Care Act Health Profession Opportunity Grants:		
Healthcare Professions Training Initiative	93.093	$81,680
Passed Through Alamo Area Resource Center		
Community Programs to Improve Minority Health		
HIV/AIDS Health Improvement for Re-Entering Ex-Offenders	93.137	$31,890
Total indirect awards		**$5,373,902**
Total federal awards		**$5,559,125**

State programs

Department of State Health Services:	
Title V Family Planning	$24,826
Breast & Cervical Cancer	48,479
Breast & Cervical Cancer	51,228
Title V Prenatal	53,940
Title V Prenatal	7,791
	$186,264
Texas Health & Human Services Commission:	
Texas Nurse-Family Partnership Program	$575,086
Texas Nurse-Family Partnership Program	248,747
	$823,833

University Health System
A Component Unit of Bexar County, Texas

Schedule of Expenditures of Federal and State Awards (continued)

State programs (continued)

Cancer Prevention & Research Institute of Texas	
A Su Salud	$53,435
Mammography Utilization Project	86,646
Colorectal Cancer Navigation Program	43,161
Colorectal Cancer Navigation Program	303,111
Colorectal Cancer Screening Promotion	20,453
Colorectal Cancer Screening Promotion	118,109
Breast Health	25,261
Cervical San Antonio HPV/PAP	450,558
	$1,100,734
Total State Awards	**$2,110,831**
Total Federal and State Awards	**$7,669,956**

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Independent Auditor's 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*

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 and the discretely presented component units 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 December 31, 2012, and the related notes to the financial statements, which collectively comprise the System's basic financial statements and have issued our report thereon dated June 18, 2013, which contained an "emphasis of matter" paragraph regarding a change in accounting principle and a reference to the report of other auditors. The financial statements of University Health System Pension Plan, included in the System's financial statements as a discretely presented component unit, was not audited in accordance with *Government Auditing Standards*. Other auditors audited the financial statements of University Health System Pension Plan, as described in our report on the System's financial statements. This report does not include the results of the other auditor's testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors.

Internal Control Over Financial Reporting

Management of the System is responsible for establishing and maintaining effective internal control over financial reporting (internal control). In planning and performing our audit, we considered the System's internal control to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions 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 efficiencies, 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 would not necessarily identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, we did not identify any deficiencies in internal control that we consider to be material weaknesses as defined above. However, material weaknesses may exist that have not been identified. We identified a certain deficiency in internal control described in the accompanying schedule of findings and responses as item 12-01 that we consider to be a significant deficiency in internal control.

Compliance

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*.

Management's Response to Finding

The System's response to the finding identified in our audit is described in the accompanying schedule of findings and responses. Management's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Other Matters

We noted certain matters that we reported to the System's management in a separate letter dated June 18, 2013.

The purpose of this communication 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 compliance. This communication 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

June 18, 2013

Schedule of Findings and Responses

Reference Number	Finding
12-01	Criteria or specific requirement – Management is responsible for establishing and maintaining effective internal control over financial reporting. Condition – Variances in general ledger account reconciliations resulted in adjustments of the financial statements to supported balances. Context and Effect – The System's financial statements required adjustments due to variances in account reconciliations that were not supportable. Cause – Certain general ledger account reconciliations prepared by staff accountants were not reviewed and variances between general ledger account balances and supporting detail were not researched or adjusted. Recommendation – Management should review current reconciliation preparation and review policies. Account reconciliations should be reviewed by a second accounting professional and account reconciliations related to particularly material and complex transactions should be reviewed by the Accounting Director and Controller. Views of responsible officials and planned corrective actions – Management concurs with the finding and recommendation and will be implementing procedures to ensure account reconciliations are reviewed, account balances are properly reconciled and reconciling issues are resolved in a timely manner.