

The University of Texas Southwestern Medical Center

(A Division of the University of Texas System)

Consolidated Financial Statements as of and for
the Years Ended August 31, 2020 and 2019, and
Independent Auditor's Report

THE UNIVERSITY OF TEXAS SOUTHWESTERN MEDICAL CENTER
(A Division of the University of Texas System)

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INDEPENDENT AUDITOR'S REPORT

To the Members of the Audit, Compliance, and
Management Review Committee of The University of
Texas System Board of Regents

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of The University of Texas Southwestern Medical Center ("UTSW"), which comprise the consolidated statements of net position as of August 31, 2020 and 2019, and the related consolidated statements of revenues, expenses, and changes in net position and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated 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 consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated net position of UTSW as of August 31, 2020 and 2019, and the changes in its net position and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1, the consolidated financial statements of UTSW are intended to present the net position, changes in net position, and cash flows of The University of Texas System attributable to UTSW. They do not purport to, and do not, present the net position of The University of Texas System as of August 31, 2020 and 2019, the changes in its net position, or cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Required Supplementary Information on pages 50-51 be presented to supplement the consolidated financial statements. Such information, although not a part of the consolidated financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the consolidated 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 consolidated financial statements, and other knowledge we obtained during our audit of the consolidated 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.

Management has omitted management's discussion and analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the consolidated financial statements. Such missing information, although not part of the consolidated financial statements, is required by the Government Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the consolidated financial statements in an appropriate operation, economic, or historical context. Our opinion on the consolidated financial statements is not affected by this missing information.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated December 10, 2020 on our consideration of UTSW's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on effectiveness of UTSW's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering UTSW's internal control over financial reporting and compliance.

Deloitte & Touche LLP

December 10, 2020

THE UNIVERSITY OF TEXAS SOUTHWESTERN MEDICAL CENTER
(A Division of the University of Texas System)

CONSOLIDATED STATEMENTS OF NET POSITION
AS OF AUGUST 31, 2020 AND 2019
(Amounts in thousands)

	2020	2019
ASSETS AND DEFERRED OUTFLOWS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 39,279	\$ 174,867
Balance in state appropriations	70,378	41,480
Patient accounts receivable—less allowance for uncollectible accounts	335,847	358,710
Other accounts receivable—less allowance for uncollectible accounts	166,578	167,478
Inventories and other current assets	65,376	60,996
Restricted—cash and cash equivalents	118,808	65,040
Loans and contracts	1,511	1,144
Contributions receivable	10,466	18,134
Due from UT System and other state agencies	<u>12,298</u>	<u>14,936</u>
Total current assets	<u>820,541</u>	<u>902,785</u>
NONCURRENT ASSETS:		
Restricted:		
Cash and cash equivalents	39,026	2,836
Loans and contracts	1,315	2,769
Investments	793,145	610,568
Contributions receivable	23,959	33,131
Due from UT System and other state agencies	25,024	81,729
Endowment investments	<u>1,583,449</u>	<u>1,180,509</u>
Total restricted assets—net	<u>2,465,918</u>	<u>1,911,542</u>
Capital assets:		
Nondepreciable assets	778,777	453,252
Depreciable assets	<u>3,757,082</u>	<u>3,569,516</u>
Total capital assets	4,535,859	4,022,768
Less accumulated depreciation and amortization	<u>(1,859,918)</u>	<u>(1,689,246)</u>
Total capital assets—net	<u>2,675,941</u>	<u>2,333,522</u>
OTHER NONCURRENT ASSETS:		
Investments	703,525	1,114,781
Other noncurrent assets	<u>168,654</u>	<u>151,088</u>
Total other noncurrent assets	<u>872,179</u>	<u>1,265,869</u>
Total assets	<u>6,834,579</u>	<u>6,413,718</u>
DEFERRED OUTFLOWS OF RESOURCES:		
Asset retirement obligation	639	1,111
Pension related	434,510	507,699
Retiree healthcare	<u>229,817</u>	<u>154,171</u>
Total deferred outflows	<u>664,966</u>	<u>662,981</u>
TOTAL ASSETS AND DEFERRED OUTFLOWS	<u>\$ 7,499,545</u>	<u>\$ 7,076,699</u>

(Continued)

THE UNIVERSITY OF TEXAS SOUTHWESTERN MEDICAL CENTER
(A Division of the University of Texas System)

CONSOLIDATED STATEMENTS OF NET POSITION
AS OF AUGUST 31, 2020 AND 2019
(Amounts in thousands)

	2020	2019
LIABILITIES AND DEFERRED INFLOWS		
CURRENT LIABILITIES:		
Accounts payable, accrued expenses, and other	\$ 374,618	\$ 349,274
Estimated third-payor settlements	19,209	24,225
Unearned revenue	44,576	54,749
Employees' compensable leave—current	53,440	55,527
Net other post-employment benefits —current	33,842	37,557
Due to UT System and other state agencies	<u>23,591</u>	<u>19,734</u>
 Total current liabilities	 <u>549,276</u>	 <u>541,066</u>
NONCURRENT LIABILITIES:		
Employees' compensable leave—noncurrent	105,379	72,781
Net pension liability	866,980	947,545
Net other post-employment benefits —noncurrent	1,874,002	1,649,094
Other noncurrent liabilities	<u>4,984</u>	<u>24,063</u>
 Total noncurrent liabilities	 <u>2,851,345</u>	 <u>2,693,483</u>
 Total liabilities	 <u>3,400,621</u>	 <u>3,234,549</u>
DEFERRED INFLOWS OF RESOURCES:		
Pension related	167,425	65,707
Retiree healthcare related	318,139	352,170
Third party beneficiary related	<u>4,677</u>	<u>4,111</u>
 Total deferred inflows of resources	 <u>490,241</u>	 <u>421,988</u>
 Total liabilities and deferred inflows	 <u>3,890,862</u>	 <u>3,656,537</u>
COMMITMENTS AND CONTINGENCIES (Note 12)		
NET POSITION:		
Net investment in capital assets	2,675,940	2,333,522
Restricted:		
Nonexpendable	1,016,704	694,634
Expendable	1,583,740	1,470,523
Unrestricted	<u>(1,667,701)</u>	<u>(1,078,517)</u>
 Total net position	 <u>3,608,683</u>	 <u>3,420,162</u>
 TOTAL LIABILITIES, DEFERRED INFLOWS, AND NET POSITION	 <u>\$ 7,499,545</u>	 <u>\$ 7,076,699</u>

See notes to consolidated financial statements.

(Concluded)

THE UNIVERSITY OF TEXAS SOUTHWESTERN MEDICAL CENTER
(A Division of the University of Texas System)

CONSOLIDATED STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
FOR THE YEARS ENDED AUGUST 31, 2020 AND 2019
(Amounts in thousands)

	2020	2019
OPERATING REVENUES:		
Net student tuition and fees	\$ 26,121	\$ 26,162
Net patient services and professional fees	2,149,186	2,182,790
Sponsored programs revenue	686,949	590,666
Sales and services of educational activities	5,921	14,138
Auxiliary and other	<u>192,593</u>	<u>161,886</u>
Total operating revenues	<u>3,060,770</u>	<u>2,975,642</u>
OPERATING EXPENSES:		
Salaries, wages, and benefits	2,437,112	2,147,890
Professional and contracted services	218,551	253,261
Materials and supplies	673,549	627,013
Maintenance and repairs	52,400	17,073
Utilities	21,706	21,073
Depreciation and amortization	181,755	183,365
Other operating expenses	<u>123,972</u>	<u>133,642</u>
Total operating expenses	<u>3,709,045</u>	<u>3,383,317</u>
OPERATING LOSS	<u>(648,275)</u>	<u>(407,675)</u>
NONOPERATING REVENUES AND EXPENSES:		
State appropriations	202,173	194,086
Gift contributions for operations	65,911	65,376
Net investment income, including change in fair value	299,602	164,511
Net other nonoperating revenue (expense)	<u>40,395</u>	<u>(7,845)</u>
Total nonoperating revenues and expenses	<u>608,081</u>	<u>416,128</u>
(LOSS) INCOME BEFORE CAPITAL CONTRIBUTIONS, ADDITIONS TO PERMANENT ENDOWMENTS, AND TRANSFERS	(40,194)	8,453
CAPITAL CONTRIBUTIONS	1,942	8,079
ADDITIONS TO PERMANENT ENDOWMENTS	14,739	13,796
TRANSFERS FROM UT SYSTEM AND STATE AGENCIES	321,269	156,220
TRANSFERS TO UT SYSTEM AND STATE AGENCIES	<u>(109,235)</u>	<u>(108,068)</u>
CHANGE IN NET POSITION	188,521	78,480
NET POSITION—Beginning of year	<u>3,420,162</u>	<u>3,341,682</u>
NET POSITION—End of year	<u>\$ 3,608,683</u>	<u>\$ 3,420,162</u>

See notes to consolidated financial statements.

THE UNIVERSITY OF TEXAS SOUTHWESTERN MEDICAL CENTER
(A Division of the University of Texas System)

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED AUGUST 31, 2020 AND 2019
(Amounts in thousands)

	2020	2019
CASH FLOWS FROM OPERATING ACTIVITIES:		
Proceeds from tuition and fees	\$ 26,885	\$ 24,961
Proceeds from third-party payors and patients	2,177,967	2,164,715
Proceeds from sponsored programs	715,625	618,806
Payments to suppliers	(1,101,239)	(984,709)
Payments to employees	(2,192,805)	(1,986,466)
Receipts for loans provided	920	1,030
Other receipts	<u>150,305</u>	<u>57,850</u>
Net cash used in operating activities	<u>(222,342)</u>	<u>(103,813)</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
Proceeds from state appropriations	173,276	190,051
Proceeds from gifts	81,234	79,149
Proceeds from private gifts for endowments and annuity life purposes	14,739	13,796
Transfers from UT System and other agencies	14,419	2,169
Transfer to UT System or other agencies		(14)
Proceeds and payments for other nonoperating activities	<u>15,559</u>	<u>(20,724)</u>
Net cash provided by noncapital financing activities	<u>299,227</u>	<u>264,427</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Proceeds from capital debt transferred from UT System	364,156	187,064
Proceeds from capital appropriations, grants, and gifts	3,458	6,018
Proceeds from sale of capital assets	61	379
Payments for additions to capital assets	(510,412)	(310,754)
Mandatory transfers to UT System for capital-related debt	<u>(109,222)</u>	<u>(107,981)</u>
Net cash used in capital and related financing activities	<u>(251,959)</u>	<u>(225,274)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sales and maturities of investments	11,381	6,520
Proceeds from interest and investment income	173,295	188,510
Payments to acquire investments	<u>(55,232)</u>	<u>(18,633)</u>
Net cash provided by investing activities	<u>129,444</u>	<u>176,397</u>
(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(45,630)	111,737
CASH AND CASH EQUIVALENTS—Beginning of year	<u>242,743</u>	<u>131,006</u>
CASH AND CASH EQUIVALENTS—End of year	<u>\$ 197,113</u>	<u>\$ 242,743</u>

(Continued)

THE UNIVERSITY OF TEXAS SOUTHWESTERN MEDICAL CENTER
(A Division of the University of Texas System)

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED AUGUST 31, 2020 AND 2019
(Amounts in thousands)

	2020	2019
RECONCILIATION OF OPERATING (EXPENSES) REVENUES TO NET CASH USED IN OPERATING ACTIVITIES:		
Operating loss	\$ (648,275)	\$ (407,675)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation and amortization	181,755	183,365
Bad debt	166	49
Change in operating assets and liabilities:		
Accounts receivable—net	42,097	(13,109)
Loans and contracts	920	1,029
Inventories	(6,492)	(7,183)
Due to UT System	2,396	944
Other current and noncurrent assets	(19,386)	(105,536)
Accounts payable, accrued expenses, and estimated third-payor settlements	(2,657)	84,773
Unearned revenue	(10,174)	(586)
Employees' compensable leave	30,510	4,978
Pension and retiree benefits related obligations, deferred inflows and outflows	205,857	153,938
Asset retirement related obligations, deferred inflows and outflows	473	474
Other current and noncurrent liabilities	468	726
	<u>\$ (222,342)</u>	<u>\$ (103,813)</u>
NET CASH USED IN OPERATING ACTIVITIES		
SUPPLEMENTAL NONCASH ACTIVITY INFORMATION:		
Unrealized gain (loss) on investments	<u>\$ 130,410</u>	<u>\$ (24,516)</u>
Unpaid purchases of capital assets in accounts payable and accrued expenses	<u>\$ 78,179</u>	<u>\$ 64,063</u>

See notes to consolidated financial statements.

(Concluded)

THE UNIVERSITY OF TEXAS SOUTHWESTERN MEDICAL CENTER (A Division of the University of Texas System)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED AUGUST 31, 2020 AND 2019

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization—The University of Texas Southwestern Medical Center (UTSW) is a division of the University of Texas System (“UT System”). The UT System is an agency of the State of Texas and reported as part of the “Colleges and Universities” major enterprise fund in the State of Texas financial statements. In 1949, UTSW became a division of the UT System. UTSW is located in Dallas, TX 75390.

Blended Component Units—The accompanying financial statements for UTSW are presented on a consolidated basis and include the accounts for UT Southwestern Health Systems (“UTSHS, Inc.”), UT Southwestern Moncrief Cancer Center (“Moncrief”), and Moncrief Cancer Foundation (the “Foundation”).

UT Southwestern Health Systems, 5323 Harry Hines Boulevard, Dallas, Texas 75390, is governed by a three-member board appointed by the president of UTSW. UTSW provides support of health care services and grants to conduct research and provide educational programs to accomplish the mission of UTSW. The corporation is blended rather than discretely presented because it is organized as a not-for-profit corporation and the president of UTSW is the sole corporate member. The corporation’s fiscal year end is August 31.

UT Southwestern Moncrief Cancer Center, 400 West Magnolia Avenue, Fort Worth, Texas 76104, is governed by a four-member board appointed by the president of UTSW. Moncrief provides resources for cancer prevention, early detection, and support services to cancer patients and their families within Tarrant County and surrounding areas. Moncrief is blended rather than discretely presented because it is organized as a not-for-profit corporation and the president of UTSW is the sole corporate member. The corporation’s fiscal year end is August 31.

Moncrief Cancer Foundation, 5323 Harry Hines Blvd., Dallas, Texas 75390, is governed by a six-member board appointed by the president of UTSW. The Foundation supports cancer prevention, early detection, and support services to cancer patients and their families within Tarrant County and surrounding areas through Moncrief. The Foundation is blended rather than discretely presented because it is organized as a not-for-profit foundation and the president of UTSW is the sole corporate member. The Foundation’s fiscal year end is August 31.

Significant Accounting Policies:

Basis of Accounting—UTSW uses the accrual method of accounting, whereby revenues are recognized in the accounting period when services are rendered and expenses are recognized when incurred. UTSW’s consolidated financial statements are reported as a business-type activity as defined by the Government Accounting Standards Board (GASB).

Tax Status—The Internal Revenue Service ruled on March 20, 1984, October 9, 1997, December 7, 2010, and May 11, 2017 that UTSW is an agency of the State of Texas. As an agency of the state, UTSW

is generally exempt from federal income taxes, although certain activities are subject to federal unrelated business income tax.

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, deferred inflows and outflows, 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.

Net Position—UTSW classifies 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 position consists of capital assets, net of accumulated depreciation. Unspent related debt proceeds are excluded from the calculation of net investment in capital assets. UTSW has not recorded outstanding debt issued to acquire capital assets as these are obligations of UT System (see Note 9).

Restricted—Nonexpendable—Net position subject to externally imposed stipulations that require the amounts to be maintained in perpetuity by UTSW. Such assets include UTSW's permanent endowment funds.

Restricted—Expendable—Net position whose use by UTSW is subject to externally imposed stipulations that can be fulfilled by actions of UTSW pursuant to those stipulations or that expire with the passage of time. Such assets include gifts for operations and investment income earned from restricted endowments, grants, loan funds, and funds restricted for capital projects.

Unrestricted—This component of net position consists of those assets that do not meet the definition of "restricted" or "investments in capital assets."

Consolidated Statements of Revenues, Expenses, and Changes in Net Position—For purposes of financial statement presentation, operating revenues include those generated from direct patient care, related support services, sponsored programs, and educational activities. Non-operating revenues consist 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 the purposes for which there are both restricted and unrestricted resources available, it is UTSW's policy to use restricted resources first to the extent that such are available, and then to use unrestricted resources.

Cash and Cash Equivalents and Investments—Short-term, highly liquid investments with maturities of three months or less when purchased are generally considered cash and cash equivalents. UTSW's policy is to exclude items that meet this definition if they are part of an investment pool that has an investment horizon of one year or greater. Therefore, highly liquid investments that are part of the Intermediate-Term Fund (ITF) and the Long-Term Fund (LTF) are not considered cash and cash equivalents. Cash held in the state treasury for the Permanent University Fund (PUF) and the Permanent Health Fund (PHF) are considered cash and cash equivalents. Other highly liquid investments of these major funds invested with custodians are not considered cash and cash equivalents according to the investment policies of UTSW and UT System.

Patient Accounts Receivable—Patient accounts receivable is presented net of allowances for contractual discounts and bad debts. The amount of bad debt allowances was approximately \$116.6 million and \$93.1 million as of August 31, 2020 and 2019, respectively. The increase in bad debt

allowance in 2020 is mainly the result of a change in the composition of accounts receivables and an adjustment in the federal poverty level guidelines resulting in additional bad debt allowance.

Cost of Charity Care—The American Institute of Certified Public Accountants defines charity care as care for which hospitals never expect to be reimbursed. Charity care occurs when a patient applies to the hospital for financial assistance and the hospital waives all or part of its charges, consistent with its internal charity care policy. Charity care costs amounted to approximately \$30.7 million and \$15.3 million for 2020 and 2019, respectively. To calculate cost of charity care, charges are converted to costs by the application of the Medicare cost to charge ratio, as calculated in the most recent Medicare cost report.

Inventories—Inventories are stated at the lower of cost (determined on an average-cost basis) or market.

Deferred Outflows and Inflows—Deferred outflows and inflows consist primarily of changes in the net pension and other post-employment benefits (OPEB) liability not included in pension or OPEB expense and are required to be reported as deferred outflows of resources or deferred inflows of resources related to pensions and OPEB. Employer contributions subsequent to the measurement date of the net pension and OPEB liabilities are also required to be reported as deferred outflows of resources.

Net Pension Liability—UTSW participates in a cost-sharing multiple-employer defined benefit pension plan with a special funding situation administered by the Teacher Retirement System of Texas (TRS). TRS is primarily funded through state and employee contributions. UTSW receives a proportional share of the net pension liability, pension-related deferred outflows, and pension-related deferred inflows from the Texas Comptroller of Public Accounts.

Other Post-Employment Benefits (OPEB) Liability—UTSW's eligible retirees are provided benefits under the UT System Employee Group Insurance Program (EGIP). The EGIP is a single-employer defined benefit OPEB plan. Under chapter 1551 of the Texas Insurance Code, Sections 310 and 311 require that the State contribute to the cost of each participant's insurance coverage. UTSW's and the State's portion of the related liabilities and deferred outflows and inflows, expensed based on contributions to OPEB, are 79.5% and 20.5%, respectfully.

Asset Retirement Obligation—The liability related to clean-up and decommissioning of items using radiation such as broadscope licenses, cyclotrons, and nuclear reactors is reported as an asset retirement obligation. The liability is measured using best estimates of current values of expected outlays.

Restricted Assets—Restricted assets include funds restricted by legal or contractual requirements, including those related to sponsored programs, donors, bond proceeds receivable, trust funds, and constitutional restrictions.

Investments—Certain investments of UTSW are managed by The University of Texas Investment Management Company (UTIMCO), a private investment corporation that provides services to UTSW and its related foundations. All investments are reported as noncurrent as these funds have an investment horizon extending beyond one year. Restricted investments include investments restricted by legal or contractual requirements, including those related to donor and constitutional restrictions.

The audited financial statements of the funds managed by UTIMCO may be found on UTIMCO's website and inquiries may be directed to UTIMCO via www.utimco.org.

Investments are reported at fair value. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between two market participants at the measurement date.

UT System is authorized to invest funds, as provided in Section 51.0031 of the Texas Education Code and the Constitution of the State of Texas, under prudent investor investment standards. Such investments include various fixed income and equity type securities, hedge funds, public market funds, and private investments. The investments of UT System are governed by various investment policies approved by the UT System Board of Regents.

Foundation investments are carried at fair value, and unrealized gains and losses are reflected in the consolidated statements of revenues, expenses, and changes in net position.

Capital Assets—Capital assets are recorded at cost at the date of acquisition or fair value at the date of donation in the case of gifts. UTSW follows the State of Texas' capitalization policy, which calls for capitalization of those items with an estimated useful life greater than one year and a cost equal to or greater than \$5,000 for equipment items; \$100,000 for buildings, building improvements, and improvements other than buildings; and \$500,000 for infrastructure items. Purchases of library books are capitalized. Routine repairs and maintenance are charged to operating expense in the year in which the expense is incurred. Outlays for construction in progress are capitalized as incurred. The capitalization thresholds for software are \$100,000 for purchased software and \$1,000,000 for internally developed software. UTSW capitalizes, but does not depreciate, works of art and historical treasures that are held for exhibition, education, research, and public service. These collections are protected and preserved.

Disposals are removed at carrying cost, less accumulated depreciation, with any resulting gain or loss included in other non-operating revenue or expense. Depreciation is recorded using the straight-line method over the estimated useful lives of the assets. Estimated useful lives for buildings are 10 to 50 years; for equipment, estimated useful lives range from 3 to 20 years. Hospital assets are depreciated based on the American Hospital Association's recommended useful life.

Capitalized interest was calculated based upon interest expense for 2018, less investment income related to long-term debt for the same period (see Note 9). Beginning fiscal year 2019, interest is no longer capitalized in accordance with GASB 89.

UTSW evaluates long-lived assets regularly for impairment under the provisions of GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. If circumstances suggest that assets may be impaired, an assessment of recoverability is performed prior to any write-down of assets. An impairment charge is recorded on those assets for which the estimated fair value is below its carrying amount. No material impairment charges to long-lived assets were recorded for the fiscal years ended August 31, 2020 and 2019.

Employees' Compensable Leave—Substantially all full-time employees earn annual leave from 8 to 21 hours per month depending upon the respective employee's years of state employment. State law permits employees to carry accrued leave forward from one fiscal year to another fiscal year with a maximum number of hours, up to 532 for those employees with 35 or more years of state service. Eligible part-time employees' annual leave accrual rates and maximum carryover are proportional to the number of hours appointed to work. Employees with at least six months of continuous state service who terminate their employment are entitled to payment for all accumulated annual leave. Both an expense and a liability are recorded as the benefit accrues to employees. Sick leave, the accumulation

of which is unlimited, is earned at the rate of eight hours per month and is paid only when an employee is off due to illness or to the estate of an employee in the event of the employee's death. The maximum sick leave that may be paid to an employee's estate is one-half of the employee's accumulated sick leave or 336 hours, whichever is less. UTSW's policy is to recognize the cost of sick leave only when paid. Eligible part-time employees' sick leave accrual rates are proportional to the number of hours appointed to work.

This obligation is usually paid from the same funding source(s) as the employee's salary or wage compensation. Changes in compensated absences during the year were as follows (in thousands):

	As of August 31, 2019	Additions	Reductions	As of August 31, 2020	Current Portion
Compensable leave	<u>\$ 128,308</u>	<u>\$ 76,830</u>	<u>\$ 46,320</u>	<u>\$ 158,818</u>	<u>\$ 53,440</u>
	As of August 31, 2018	Additions	Reductions	As of August 31, 2019	Current Portion
Compensable leave	<u>\$ 123,330</u>	<u>\$ 68,533</u>	<u>\$ 63,555</u>	<u>\$ 128,308</u>	<u>\$ 55,527</u>

Unearned Revenue—UTSW receives grant funds from public and private entities. Unearned revenue consists primarily of amounts received in advance, such as student tuition and fees related to future fiscal years. Unearned revenue also includes amounts received from grant and contract sponsors, which have not yet been earned under the terms of the agreement.

State Appropriations—The appropriation of tax revenues by the Texas Legislature ("Legislature") is in the form of general revenue. The Legislature meets every odd-numbered year and approves a two-year budget (biennial) for all state agencies. The general revenue appropriation to UTSW primarily supports the instruction and research missions of UTSW. Approximately 85.4% of UTSW's state appropriation is calculated based on formulas using space, research expenditures, graduate medical education, and mission-specific support. The balance of the state appropriation provides for health care, education, and tuition revenue bond retirement for infrastructure support. There is no assurance that the Legislature will continue its state appropriations to UTSW in future years; however, UTSW expects that the Legislature will continue to do so.

Net Patient Services Revenue—UTSW has agreements with third-party payors that provide reimbursement to UTSW at amounts different from its established rates. Contractual adjustments under third-party reimbursement programs represent the difference between UTSW's established rates for services and the amounts reimbursed by third-party payors.

Allowances for uncollectible amounts are estimated using historical experience, current trend and policy information, aged account balances, and a collectability analysis. Net patient services revenue in the accompanying consolidated statements of revenues, expenses, and changes in net position is net of contractual adjustments and bad debt provisions, which total approximately \$4.0 billion and \$3.8 billion for the years ended August 31, 2020 and 2019, respectively.

In accordance with provisions of the Medicare and Medicaid programs, inpatient services to Medicare and Medicaid beneficiaries are paid at prospectively determined rates per discharge based on a patient classification system utilizing clinical, diagnostic, and other factors. Medicare outpatient services are

reimbursed on a prospective basis through ambulatory payment classifications, which are based on clinical resources used in performing the procedure. Medicaid outpatient services are paid based on the lower of reasonable costs or customary charges, a fee schedule, or blended rates. For certain costs, as defined by the Medicare program, including kidney acquisition, medical education, and bad debts, additional reimbursement is provided based on cost pass-through payments and the cost report.

Medicare and Medicaid cost-reimbursable items are reimbursed to UTSW at a tentative rate, with final settlement determined after submission of annual cost reports by UTSW, which are subject to audit by the intermediaries prior to final settlement. Any differences between final audited settlements and amounts accrued at the end of the prior reporting period are included currently in the consolidated statements of revenues, expenses, and changes in net position as an adjustment to the appropriate allowance account. Such adjustments increased net patient services revenue by \$2.4 million and \$3.9 million for 2020 and 2019, respectively. UTSW's cost reports have been audited by the fiscal intermediaries through 2016 for Medicare and Medicaid with the exception of 2005 and settled through 2016. Cost reports for both programs are subject to certain reopenings and appeals as per federal and state regulations. UTSW has (assets) liabilities of approximately (\$3.2) million and \$4.9 million as of August 31, 2020 and 2019, respectively, related to the estimated Medicare and Medicaid cost report settlements.

Sponsored Program Revenues—Sponsored program revenues are received primarily from governmental and private sources and relate to research programs that normally provide for the recovery of direct and indirect costs.

Notes Payable—September 2014, the Foundation obtained a note in the amount of \$19,000,000 from a bank for the purpose of financing construction of the Moncrief Cancer Center building. The note was due on August 31, 2015, with an interest rate of the adjusted London InterBank Offered Rate (LIBOR), plus 0.8%. On August 31, 2015 and August 26, 2017, the Foundation's board approved the renewal of the note for further two years. On August 28, 2019 the Foundation's board approved the renewal of the note to be due August 28, 2021 that bears a fixed rate of 2.49% per annum. The note is collateralized by a security interest in Foundation investments held by the bank in the amount of \$68,995,036 as of August 31, 2020. The outstanding loan balance as of August 31, 2020 and 2019 was \$19,000,000 and is included in the Statements of Net Position in current liabilities.

Incentive Payments for Meaningful Use of Electronic Health Records—The American Recovery and Reinvestment Act of 2009 established incentive payments under the Medicare and Medicaid programs for hospitals, physicians, and other professionals that "meaningfully use" certified electronic health record (EHR) technology. To qualify, providers must attest to the Centers for Medicare and Medicaid Services (CMS) that they are using certified EHR in a meaningful way by meeting objectives at established thresholds as defined by CMS.

UTSW recognizes Medicaid EHR incentive payments in its consolidated statements of revenues, expenses, and changes in net position when all the eligibility requirements are met, which include: (1) CMS approves a state's EHR incentive plan and (2) its hospital or employed physician acquires certified EHR. Medicare and Medicaid EHR incentive payments for subsequent payment years are recognized in the period during which the specified meaningful use criteria are met. UTSW recognizes Medicare EHR incentive when all eligibility requirements are met, which include: (1) the specified meaningful use criteria are met and (2) contingencies in estimating the amount of the incentive payments to be received are resolved. During the years ended August 31, 2020 and 2019, UTSW satisfied the CMS adopt/implement/upgrade and/or meaningful use criteria. As a result, UTSW

recognized as revenue \$459,000 and \$731,963 for the years ended August 31, 2020 and 2019, respectively, and a cumulative amount of \$48,540,916 for all years of the program.

COVID-19—In January 2020, the World Health Organization declared the novel coronavirus (COVID-19) a Public Health Emergency of International Concern. On March 13, 2020, the Governor of the State of Texas declared a state of emergency. On March 19, 2020, the Governor signed Executive Orders to mitigate the spread of COVID-19 in Texas that closed all non-essential businesses and services statewide, canceled or postponed all non-essential gatherings of individuals, and emphasized social distancing practices in business and personal life. The orders resulted in work-from-home policies, travel restrictions, online education and closure of student residential buildings, and cancellation of events. In addition, the restrictions required rescheduling of elective or non-critical surgical and procedural cases along with non-urgent and routine provider appointments, as well as redeployment of resources to address the novel coronavirus needs. This resulted in reduced hospital and faculty practice patient care revenues and operating cash flows. To alleviate the economic impact, Congress passed the Coronavirus Aid, Relief, and Economic Security (CARES) Act. The CARES Act provides economic grants to offset additional expenses and forgone revenue in the amount of \$42,459,638, which has been reported as Net other non-operating revenue. In mid-April, consistent with the guidance from regulatory agencies, UTSW resumed surgical and professional services that were postponed in March and early April. The outbreak of COVID-19 has caused domestic and global disruption in operations for institutions of higher education and healthcare organizations. Other adverse consequences of COVID-19 or any other similar outbreaks in the future may include, but are not limited to, decline in student enrollment, decline in demand for student housing, decline in demand for UTSW programs that involve travel or that have international connections, and declines in patient service revenues. UTSW continues to carefully monitor developments and the directives of federal, state and local officials to determine what additional precautions and procedures may need to be implemented. While the COVID-19 outbreak has adversely impacted UTSW's fiscal year 2020 results, UTSW cannot at this time accurately predict the full extent to which the COVID-19 outbreak will affect UTSW's future finances and operations.

GASB Statements Implemented in Fiscal Year 2020:

GASB Statement No. 84, *Fiduciary Activities*, effective 2020, establishes criteria for identified fiduciary activities which should be reported in a fiduciary fund in the financial statements, had no impact on UTSW because we do not have fiduciary funds.

Paragraphs 4 and 5 of GASB Statement No. 97, *Certain Component Unit Criteria, and Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans: an amendment of GASB Statements No. 14 and No. 84, and a supersession of GASB Statement No. 32*, are effective in 2020. This statement clarifies that, for defined contribution pension plans, defined contribution OPEB plans, or other employee benefit plans, primary governments that perform the duties that a governing board typically performs in the absence of a governing board is not the same as the appointment of a voting majority of a governing board in determining whether they are financially accountable. This statement also limits the applicability of the financial burden criterion in paragraph 7 of Statement 84 to defined benefit pension plans and defined benefit OPEB plans that are administered through trusts that meet the criteria in paragraph 3 of Statement 67 or paragraph 3 of Statement 74. This additional guidance further solidifies the conclusion that UTSW does not have any pension or OPEB related fiduciary funds or component units.

GASB Statement No. 90, *Majority Equity Interests*, effective 2020, improved the consistency and comparability of reporting majority equity interests in a legally separate organization and improved the relevance of financial statement information for certain component units. While GASB Statement No. 95 allowed for an extension of one year to implement the statement, the State Comptroller’s Office and UT System decided to implement GASB Statement No. 90 in 2020. The implementation of Statement 90 had no impact on UTSW.

GASB Statement No. 92, *Omnibus 2020*, paragraph 4, 5, 11, and 13 are effective upon issuance, all else effective 2022, enhances comparability in accounting and financial reporting and improves the consistency of authoritative literature by addressing practice issues identified during implementation of certain GASB Statements. The paragraphs included above of Statement 92 had no effect on UTSW’s net position or changes in net position.

GASB Statement No. 95, *Postponement of the Effective dates of Certain Authoritative Guidance*, Effective Immediately, provides temporary relief to governments in light of the COVID-19 pandemic by delaying the implementation dates of many standards by one year.

GASB Statements Implemented in Fiscal Year 2019:

GASB Statement No. 83, *Certain Asset Retirement Obligations (AROs)*, effective 2019, addresses financial reporting for AROs related to clean-up and decommissioning of items using radiation such as broadscope licenses, cyclotrons, nuclear reactors, etc.

GASB Statement No. 88, *Certain Disclosures Related to Debt, Including Direct and Direct Placements*, effective 2019, had no impact on UTSW because we do not participate in direct borrowings, direct placements or have lines of credit.

GASB Statement No. 89, *Accounting for Interest Cost Incurred before the End of a Construction Period*, discontinued the capitalization of interest costs during construction. Although this statement is effective 2021, the Texas State Comptroller’s Office decided to early implement this standard in 2019.

2. DEPOSITS AND INVESTMENTS

Deposits of Cash in Bank—The carrying amount of deposits was \$5,818,208 and \$8,724,327 as of August 31, 2020 and 2019, respectively, as presented below (in thousands):

	2020	2019
Carrying amount of deposits	\$ 5,818	\$ 8,724
Cash in state treasury	33,258	18,926
Cash equivalent investments in UTIMCO	156,243	214,735
Other	<u>1,794</u>	<u>358</u>
 Total cash and cash equivalents	 <u>\$ 197,113</u>	 <u>\$ 242,743</u>

UTSW has invested in the UTIMCO Short-Term Fund (STF); these funds are invested in money markets. As of August 31, 2020 and 2019, UTSW had \$156,243,002 and \$214,735,280, respectively, invested in the STF. As noted above, these funds are included in cash and cash equivalents.

Cash Held by UTSW Deposit Risk:

Custodial Credit Risk—Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, UTSW will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party. UTSW maintains depository relationships with various banking institutions. UTSW’s policy is that all deposits are governed by a bank depository agreement between UTSW and the respective banking institution. This agreement provides that UTSW’s deposits, to the extent such deposits exceed the maximum insured limit under deposit insurance provided by the Federal Deposit Insurance Corporation, shall at all times be collateralized with either government securities or a surety bond issued by an insurer rated “AAA” or its equivalent by a nationally recognized rating organization or a combination thereof. As of August 31, 2020 and August 31 2019, there were no bank balances exposed to custodial risk as uninsured and uncollateralized deposits.

Investments:

Investments are reported at fair value. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between two market participants at the measurement date. GAAP provides a hierarchy that prioritizes the inputs of fair value measurements based on the extent to which inputs to valuation techniques are observable in the marketplace. The hierarchy assigns a higher priority to observable inputs that reflect verifiable information obtained from independent sources, and a lower priority to unobservable inputs that would reflect management’s assumptions about how market participants would value an asset or liability based on the best information available. Fair value measurements must maximize the use of observable inputs and minimize the use of unobservable inputs.

The three levels of the hierarchy of inputs used to measure fair value are as follows:

Level 1—Unadjusted quoted prices in active markets for identical assets or liabilities that are available at the measurement date.

Level 2—Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

Level 3—Unobservable inputs.

UTSW’s investments with readily available fair values are primarily valued on the basis of market valuations provided by independent pricing services.

GAAP permits management to fair value certain investments that do not have a readily determinable fair value using the investment’s net asset value (NAV) per share or UTSW’s ownership interest in partners’ capital as a practical expedient. Investments valued in this manner are not classified in the fair value hierarchy.

Investments Held in UTIMCO Funds—As discussed in Note 1, UTSW has investments held by, and under the management of UTIMCO, a private investment corporation that provides services to the UT System and its related foundations. UTSW’s UTIMCO investments are held at NAV.

- As of August 31, 2020 and 2019, investments held by UTIMCO in its Intermediate Term Fund (ITF) on behalf of UTSW were \$1,062,309,072 and \$1,319,660,798, respectively. The ITF includes investments in fixed-income and equity securities in both domestic and international markets. In addition to traditional exchange-traded equity and fixed-income securities, the portfolio includes

marketable alternative investments, hedge funds, and various other specialized public market investments. UTSW's investments in the ITF are redeemable monthly. Redemption requests from the ITF should be initiated on or before the last business day of the month. ITF transactions will be effective on the first business day of the following month; however, proceeds from ITF redemptions may take up to five business days depending upon the liquidity available in the ITF. For ITF transactions greater than \$25 million, at least three business days' notice is required.

- UTSW holds investments in UTIMCO's LTF and the PHF, which are invested in a combination of government and nongovernment securities, which include various fixed-income and equity-type securities as well as alternative investments, such as hedge funds, private equity funds and specialized public market investments. The Foundation, a blended component unit of UTSW, also hold investments in the LTF. UTSW's investment in the LTF and PHF as of August 31, 2020 and 2019 was \$1,823,089,449.29 and \$1,479,076,356, respectively. LTF investments are redeemable quarterly. If the withdrawal is greater than \$25 million, advance notice of sixty business days shall be required prior to the quarterly valuation date. If the withdrawal is for less than \$25 million, advance notice of five business days shall be required prior to the quarterly valuation date. PHF investments are nonredeemable by UTSW.
- Investment income for the years ended August 31, 2020 and 2019 was as follows:

	2020	2019
Net interest income and realized gains	\$ 173,937,707	\$ 186,628,869
Net unrealized gains/(loss)	<u>130,409,663</u>	<u>(24,515,681)</u>
Investment income	<u>\$ 304,347,370</u>	<u>\$ 162,113,188</u>

Custodial Credit Risk—The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, UTSW will not be able to recover the value of its investment or collateral securities that are in the possession of another party. Texas state statutes and UTSW's investment policy statements do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments. Further, 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. As of August 31, 2020 and 2019, UTSW did not have any investments that are exposed to custodial credit risk.

Concentrations of Credit Risk—UTSW's investment policy statement contains the limitation that no more than 5% for the fair value of domestic fixed-income securities may be invested in corporate or municipal bonds of a single issuer. UTSW does not hold any direct investments in any one issuer that represents 5% or more of total investments.

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 value to changes in market interest rates. One of the ways that UTSW manages its exposures to interest rate risk is by investing in UTIMCO's Investment Portfolios. Inherent Interest rate risk in UTIMCO is measured by monitoring the modified duration of the overall investment portfolio. Modified duration estimates the sensitivity of UTIMCO's investments to changes in interest rates. UTIMCO has no specific policy statement limitations with respect to its overall modified duration.

Foreign Currency Risk—Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of UTSW's non-US dollar investments. There are no limitations on investments in

non-US-denominated bonds or common stocks in relation to UTSW's total fixed-income and developed country equity exposures in UT System's investment policy statements. However, these types of investments are typically not a significant portion of the investment strategy.

Other Investments Held by UT System—UTSW also has other investments held by UT System for the purpose of endowment, annuity and life income funds. These separately invested assets totaled \$74,039,213 and \$21,761,215 as of August 31, 2020 and 2019, respectively. These holdings are primarily invested in publicly listed money market funds categorized as Level 1 in the fair value hierarchy.

Investments Held by UTSW—Investments not held by UT System are recorded in the Statement of Net Position in noncurrent assets—restricted assets and assets held for others.

Debt securities include U.S. treasury securities and corporate obligations. U.S. government obligations are valued based on unadjusted prices in active markets and are categorized as Level 1. Corporate obligations are valued based on multiple quotations or models utilizing observable market inputs and are categorized as Level 2.

Fair values of equity securities, including domestic and international stocks, are based on the closing price on the primary exchange on which they are traded (if a closing price is not available, the average of the last reported bid and ask price is used). When these securities are actively traded, and valuation adjustments are not applied, they are categorized as Level 1.

Fixed-income money market and bond mutual funds consist primarily of money market investments, foreign currencies, and overnight funds. Investments in publicly listed money market funds are categorized as Level 1.

Investments include a \$1.7 million and \$1.6 million trust held at Bank of America categorized as miscellaneous as of August 31, 2020 and 2019.

Hedge funds are valued using NAV. The Foundation is fully redeemed from the hedge fund and there is no longer a redemption frequency schedule. The remaining value of \$427,124 as of August 31, 2020 is in the form of a designated investment which is not redeemable or transferable and will remain in the fund until the underlying investments are unwound. As of August 31, 2019, the hedge fund value was \$5,436,684, not including unfunded commitments of \$6,040,956.

FAIR VALUE MEASUREMENTS—Held outside of UTIMCO

Fair value measurements as of August 31, 2020:

	Level 1	Level 2	Level 3	NAV	Total
Equity securities	\$ 66,324,899	\$ -	\$ -	\$ -	\$ 66,324,899
International equity	257,094	-	-	-	257,094
Fixed income and bond funds	24,638,558	-	-	-	24,638,558
Moncrief Cancer Institute	1,689,190	-	-	-	1,689,190
Private investments	-	-	27,344,003	-	27,344,003
Hedge funds	-	-	-	427,124	427,124
Total	<u>\$ 92,909,741</u>	<u>\$ -</u>	<u>\$ 27,344,003</u>	<u>\$ 427,124</u>	<u>\$ 120,680,868</u>

The fair value measurements as presented above are comprised of the Foundation's investments of \$91,390,581, Tech Stocks \$27,601,097, and Moncrief's investments of \$1,689,190.

Fair value measurements as of August 31, 2019:

	Level 1	Level 2	Level 3	NAV	Total
Equity securities	\$53,874,681	\$ -	\$ -	\$ -	\$53,874,681
International equity	111,756	-	-	-	111,756
Fixed income and bond funds	22,776,308	-	-	-	22,776,308
Moncrief Cancer Institute	1,567,923	-	-	-	1,567,923
Private investments	-	-	1,591,576	-	1,591,576
Hedge funds	-	-	-	5,436,684	5,436,684
Total	<u>\$78,330,668</u>	<u>\$ -</u>	<u>\$1,591,576</u>	<u>\$5,436,684</u>	<u>\$85,358,928</u>

The fair value measurements as presented above are comprised of the Foundation's investments of \$82,087,673, Tech Stocks \$1,703,332, and Moncrief's investments of \$1,567,923.

Investments Held by the Foundation—The fair value of investments held by the Foundation as of August 31, 2020 and 2019, amounted to \$103,489,906 and \$95,160,352 respectively.

Investments are authorized by the Foundation's Amended and Restated Investment Policy (the "Policy"), which provides that assets shall be allocated among a number of managers with different investment styles. By diversifying assets among managers whose performance returns may vary, the Foundation seeks to reduce the overall risk of its portfolio. This includes risks related to changing interest rates and foreign currencies exchange rates, credit default of issuers, and credit concentration among any one issuer.

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 value to changes in market interest rates.

One of the ways that the Foundation manages its exposures to interest rate risk is by investing in a combination of shorter-term and longer-term investments.

Credit Risk—Credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. The Policy of the Foundation provides that assets shall be allocated among a number of managers with different investment styles. By diversifying assets among managers whose performance returns may vary, the Foundation seeks to reduce the overall risk of its portfolio, including credit risk. The Foundation's investments in the hedge fund and UTIMCO are subject to market risk as well as the risk that the manager will not be able to redeem the shares. The Foundation reviews the performance of the managers to determine when to redeem the investments.

Custodial Credit Risk—The custodial credit risk for investments is the risk that, in the event of failure of the counterparty to a transaction, the Foundation will not be able to recover the value of its investments that are in possession of another party. All the Foundation's investments are registered in the Foundation's name. The majority of investments are held by the Foundation's depository bank, while the underlying investments of the hedge fund and UTIMCO are held by the manager or its custodian. The Foundation did not have any investments that are exposed to custodial credit risk.

Concentration of Credit Risk—Concentration of credit risk is the risk of loss attributed to the magnitude of the Foundation’s investment in a single issuer. By diversifying assets among managers whose performance returns may vary, the Foundation seeks to reduce the overall risk of its portfolio, including concentration of credit risk.

Foreign Currency Risk—Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or deposit. There were no investments held in foreign currency as of August 31, 2020 and 2019. In addition, the Foundation’s investments in the hedge fund and UTIMCO may also contain investments in foreign currencies subjecting the investments to foreign currency risk. However, these types of investments are typically not a significant portion of the manager’s investment strategy.

3. CAPITAL ASSETS

Capital assets as of August 31, 2020 are summarized as follow (in thousands):

2020	Balance— August 31, 2019	Additions/ Transfers	Retirements/ Transfers	Balance— August 31, 2020
Nondepreciable assets:				
Land	\$ 90,774	\$ 5,997	\$ -	\$ 96,771
Construction in progress	354,170	346,315	(28,115)	672,370
Nondepreciable collections	<u>8,308</u>	<u>1,328</u>	<u>-</u>	<u>9,636</u>
Total nondepreciable assets	<u>453,252</u>	<u>353,640</u>	<u>(28,115)</u>	<u>778,777</u>
Depreciable assets:				
Buildings and improvements	2,655,601	81,532	-	2,737,133
Equipment	703,681	112,660	(11,817)	804,524
Software	<u>210,234</u>	<u>5,439</u>	<u>(248)</u>	<u>215,425</u>
Total depreciable assets	<u>3,569,516</u>	<u>199,631</u>	<u>(12,065)</u>	<u>3,757,082</u>
Less accumulated depreciation:				
Buildings and improvements	(1,043,664)	(102,630)	-	(1,146,294)
Equipment	(469,065)	(68,000)	10,834	(526,231)
Software	<u>(176,517)</u>	<u>(11,125)</u>	<u>248</u>	<u>(187,394)</u>
Total accumulated depreciation	<u>(1,689,246)</u>	<u>(181,755)</u>	<u>11,082</u>	<u>(1,859,919)</u>
Depreciable assets—net	<u>1,880,270</u>	<u>17,876</u>	<u>(983)</u>	<u>1,897,163</u>
Capital assets—net	<u>\$ 2,333,522</u>	<u>\$ 371,516</u>	<u>\$(29,098)</u>	<u>\$ 2,675,940</u>

Capital assets as of August 31, 2019 are summarized as follow (in thousands):

2019	Balance— August 31, 2018	Additions/ Transfers	Retirements/ Transfers	Balance— August 31, 2019
Nondepreciable assets:				
Land	\$ 75,707	\$ 15,067	\$ -	\$ 90,774
Construction in progress	163,268	243,995	(53,093)	354,170
Nondepreciable collections	<u>6,487</u>	<u>1,821</u>	<u>-</u>	<u>8,308</u>
Total nondepreciable assets	<u>245,462</u>	<u>260,883</u>	<u>(53,093)</u>	<u>453,252</u>
Depreciable assets:				
Buildings and improvements	2,628,826	27,408	(633)	2,655,601
Equipment	671,233	55,278	(22,830)	703,681
Software	<u>184,541</u>	<u>25,693</u>	<u>-</u>	<u>210,234</u>
Total depreciable assets	<u>3,484,598</u>	<u>108,379</u>	<u>(23,463)</u>	<u>3,569,516</u>
Less accumulated depreciation:				
Buildings and improvements	(941,242)	(102,636)	214	(1,043,664)
Equipment	(424,971)	(65,284)	21,190	(469,065)
Software	<u>(160,856)</u>	<u>(15,661)</u>	<u>-</u>	<u>(176,517)</u>
Total accumulated depreciation	<u>(1,527,069)</u>	<u>(183,581)</u>	<u>21,404</u>	<u>(1,689,246)</u>
Depreciable assets—net	<u>1,957,529</u>	<u>(75,202)</u>	<u>(2,059)</u>	<u>1,880,270</u>
Capital assets—net	<u>\$ 2,202,991</u>	<u>\$ 185,681</u>	<u>\$ (55,152)</u>	<u>\$ 2,333,522</u>

The renovations of the Dan Danciger Research Building and the Karl Hoblitzelle Clinical Science Building Buildings were placed in service in fiscal year 2019.

4. COMPONENT UNIT CONDENSED FINANCIAL STATEMENTS

Component unit condensed financial statements are presented below (in thousands) for UTSHS, Inc., Moncrief, and Foundation as of and for the year ended August 31, 2020.

	UTSHS, Inc.	Moncrief	Foundation	Total
Condensed statement of net position:				
Current assets	\$ 4,471	\$ 3,376	\$ 1,872	\$ 9,719
Capital assets		28,664		28,664
Other assets	<u>9,104</u>	<u>1,689</u>	<u>103,490</u>	<u>114,283</u>
Total assets	<u>13,575</u>	<u>33,729</u>	<u>105,362</u>	<u>152,666</u>
Current liabilities	<u>-</u>	<u>(2,686)</u>	<u>(19,060)</u>	<u>(21,746)</u>
Total liabilities	<u>-</u>	<u>(2,686)</u>	<u>(19,060)</u>	<u>(21,746)</u>
Net investment in capital assets	-	28,663	-	28,663
Restricted-nonexpendable	-	1,689	-	1,689
Restricted-expendable	-	-	86,302	86,302
Unrestricted	<u>13,575</u>	<u>691</u>	<u>-</u>	<u>14,266</u>
Total net position	<u>\$ 13,575</u>	<u>\$ 31,043</u>	<u>\$ 86,302</u>	<u>\$ 130,920</u>
Condensed statement of revenues, expenses and changes in net position:				
Operating revenues	\$ 25	\$ 7,024	\$ -	\$ 7,049
Operating expenses	(34)	(10,174)	(571)	(10,779)
Depreciation	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Operating loss	(9)	(3,150)	(571)	(3,730)
Net investment income	3,514	121	13,061	16,696
Gift contributions for operations	<u>-</u>	<u>103</u>	<u>16</u>	<u>119</u>
Income (loss) income before other changes in net positions	3,505	(2,926)	12,506	13,085
Transfers/other changes in net position	<u>(7,452)</u>	<u>1,545</u>	<u>(1,331)</u>	<u>(7,238)</u>
Change in net position	(3,947)	(1,381)	11,175	5,847
Net position—August 31, 2019	<u>17,522</u>	<u>32,424</u>	<u>75,127</u>	<u>125,073</u>
Net position—August 31, 2020	<u>\$ 13,575</u>	<u>\$ 31,043</u>	<u>\$ 86,302</u>	<u>\$ 130,920</u>
Condensed statement of cash flows:				
Net cash provided by (used in):				
Operating activities	\$ (1,124)	\$ (1,952)	\$ (1,303)	\$ (4,379)
Investing activities	<u>(154)</u>	<u>67</u>	<u>2,446</u>	<u>2,359</u>
Net (decrease) increase in cash and cash equivalents	(1,278)	(1,885)	1,143	(2,020)
Cash and cash equivalents—August 31, 2019	<u>5,748</u>	<u>3,126</u>	<u>657</u>	<u>9,531</u>
Cash and cash equivalents—August 31, 2020	<u>\$ 4,470</u>	<u>\$ 1,241</u>	<u>\$ 1,800</u>	<u>\$ 7,511</u>

Component unit condensed financial statements are presented below (in thousands) for UTSHS, Inc., Moncrief, and Foundation as of and for the year ended August 31, 2019.

	UTSHS, Inc.	Moncrief	Foundation	Total
Condensed statement of net position:				
Current assets	\$ 17,523	\$ 2,713	\$ 731	\$ 20,967
Capital assets	-	27,497		27,497
Other assets	-	5,944	95,161	101,105
	<u>17,523</u>	<u>36,154</u>	<u>95,892</u>	<u>149,569</u>
Total assets				
Current liabilities	-	1,975	20,764	22,739
	<u>-</u>	<u>1,975</u>	<u>20,764</u>	<u>22,739</u>
Total liabilities				
Net investment in capital assets	-	27,497	-	27,497
Restricted-nonexpendable	-	1,896	-	1,896
Restricted-expendable	-	-	75,128	75,128
Unrestricted	17,523	4,786	-	22,309
	<u>17,523</u>	<u>4,786</u>	<u>-</u>	<u>22,309</u>
Total net position	<u>\$ 17,523</u>	<u>\$ 34,179</u>	<u>\$ 75,128</u>	<u>\$ 126,830</u>
Condensed statement of revenues, expenses and changes in net position:				
Operating revenues	\$ 14	\$ 9,199	\$ -	\$ 9,213
Operating expenses	(34)	(12,941)	(557)	(13,532)
Depreciation	-	1,179	-	1,179
	<u>-</u>	<u>1,179</u>	<u>-</u>	<u>1,179</u>
Operating income (loss)	(20)	(2,563)	(557)	(3,140)
Net investment income (loss)	1,901	(7)	360	2,254
Gift contributions for operations	-	3,174	18	3,192
	<u>-</u>	<u>3,174</u>	<u>18</u>	<u>3,192</u>
Income (loss) income before other changes in net positions	1,881	604	(179)	2,306
Transfers/other changes in net position	(931)	(60)	(3,138)	(4,129)
	<u>(931)</u>	<u>(60)</u>	<u>(3,138)</u>	<u>(4,129)</u>
Change in net position	950	544	(3,317)	(1,823)
Net position—August 31, 2018	16,573	33,635	78,445	128,653
	<u>16,573</u>	<u>33,635</u>	<u>78,445</u>	<u>128,653</u>
Net position—August 31, 2019	<u>\$ 17,523</u>	<u>\$ 34,179</u>	<u>\$ 75,128</u>	<u>\$ 126,830</u>
Condensed statement of cash flows:				
Net cash provided by (used in):				
Operating activities	\$ 254	\$ 1,181	\$ 338	\$ 1,773
Investing activities	(25)	85	(902)	(842)
	<u>(25)</u>	<u>85</u>	<u>(902)</u>	<u>(842)</u>
Net decrease (increase) in cash and cash equivalents	229	1,266	(564)	931
Cash and cash equivalents—August 31, 2018	5,519	1,860	1,221	8,600
	<u>5,519</u>	<u>1,860</u>	<u>1,221</u>	<u>8,600</u>
Cash and cash equivalents—August 31, 2019	<u>\$ 5,748</u>	<u>\$ 3,126</u>	<u>\$ 657</u>	<u>\$ 9,531</u>

5. RISK FINANCING AND RELATED INSURANCE

UT System has eight funded self-insurance plans providing coverage in the following areas: employee health and dental, unemployment compensation, workers' compensation, medical professional liability, property protection, directors and officers/employment practices, construction contractor insurance, and automobile, property and liability. UTSW is covered under these individual insurance plans; the related liability is recorded at UT System level. UTSW disperses funds to UT System for payment of its pro rata share of costs related to these insurance programs.

Employee Health and Dental Insurance—The UT System Employee Group Insurance (EGI) program provides health and dental coverage to all benefits-eligible employees and retirees of UT System and its 14 institutions. These insurance benefits are provided through a self-insured plan and fully insured health maintenance organizations. UT System's Office of EGI is responsible for the overall administration of the insurance plans. EGI was established by Article 3.50-2 of the Texas Insurance Code and complies with state laws and statutes pertinent to employee benefits for the UT System.

Unemployment Compensation Insurance—The General Appropriations Act requires the UT System to reimburse the Texas Workforce Commission (TWC) for 50% of the unemployment benefits paid to former employees that were paid from general revenue funds. The UT System reimburses the TWC 100% of the unemployment benefits paid to former employees that were paid from local funds.

Workers' Compensation Insurance (WCI)—The UT System WCI program provides system wide coverage to all employees of the UT System and its 14 institutions. Under the oversight of the UT System's Business and Administrative Services (BAS), the UT System self-insures and administers the program through the use of a third party administrator.

The BAS staff is responsible for administering the UT System-wide WCI program, which provides income and medical benefits to all employees who have sustained job-related injuries or occupational diseases. The program's statutory authority is embodied in Chapter 503 of the Texas Labor Code.

Professional Medical Liability Benefit Plan—The coverage provided under the Professional Medical Liability Benefit Plan (the "Plan") is on an occurrence basis; thus, a participant is covered by the Plan for claims and lawsuits relating to events that occurred while enrolled in the Plan, including those filed after the participant has left the system's employment or training. The Plan covers all of the system staff physicians, dentists, residents, fellows, and medical and dental-students who have been enrolled as well as all healthcare professional staff members and faculty who are licensed, certified or registered to provide patient care. The limits of liability of the Plan include an annual policy aggregate of \$30 million, an annual aggregate of \$1.5 million for each staff physician, resident, fellow and healthcare professional (\$500,000 per claim) and a \$75,000 annual aggregate for each medical and dental student (\$25,000 per claim). Additional coverage is available outside of Texas and for approved international activities. Liability is limited to \$2 million per claim, regardless of the number of claimants or plan participants involved in an incident.

The limits of liability are prescribed by law as \$100,000 per health care liability claim per physician determined to be a public servant. U. T. institutions are covered under the Plan for actions that could have been brought against an individual plan participant. The liability of a U. T. institution is limited by law to \$250,000 per person injured and \$500,000 per occurrence for bodily injury or death.

Comprehensive Property Protection Program (CPPP)—The CPPP uses a combination of interim financing and commercial insurance to provide Fire and All Other Perils (“Fire and AOP”) coverage, as well as coverage for Named Windstorm and Flood (“Wind and Flood”). All coverage is subject to the terms, exclusions, limits, and conditions of the insurance policies. The Fire and AOP program provides a \$1.3 billion per occurrence limit for most perils, with sub limits that apply. UT System participates in a seven percent (7%) quota share of the primary \$75,000,000 layer excess of the \$25,000,000 layer of commercial insurance coverage. Deductibles for Fire and AOP are \$5,000,000 per occurrence as a system (\$250,000 for the institution with the loss) with a \$15,000,000 annual aggregate limit. Coverage for Wind and Flood and resulting perils provides a \$250,000,000 per occurrence limit also on a quota share basis as mentioned for Fire and AOP; a deductible of \$50,000,000 per occurrence applies for UT System (\$250,000 for the institution with the loss).

In addition, primary policies are purchased on certain Wind and Flood-exposed properties. These policies provide underlying limits (up to \$4.4 million per building/contents for wind and \$1 million maximum building/contents for flood) and are purchased through the Texas Windstorm Insurance Association and the National Flood Insurance Program for facilities in Tier 1 seacoast territories and for properties located in various flood zones. The interim financing component of the program participates in losses resulting from physical damage that exceed the coverage available under these primary policies and the institution’s deductible. The interim financing for the Wind and Flood program is funded by annual contributions made by UTSW in addition to paying insurance premiums.

Directors and Officers (D&O)/Employment Practices Liability (EPL) Self- Insurance Plans (the “Plans”)—The Plans provide coverage for claims arising from actual or alleged wrongful acts performed by the Plans’ beneficiaries. The Plans also provide coverage for EPL claims, such as wrongful termination, failure to promote, and wrongful discipline. In 2003, the UT System Board of Regents allocated \$3.7 million from the Available University Fund (AUF) to establish the D&O/EPL loss reserve fund. Institutions make annual premium contributions to this fund.

Coverage applies to individual board members, employees, faculty, etc., as well as to the UT System itself. The limit of liability is a \$10 million annual aggregate (Coverages A, B, and C combined), except for \$5 million annual aggregate sublimit for Coverage C. Coverage A applies to non-indemnifiable claims made against individuals and it has no deductible. Coverage B applies to a UT System institution that is required to indemnify a covered individual with deductibles of \$100,000 per individual and \$300,000 per occurrence. Coverage C applies to a UT System institution and related entities with a \$300,000 deductible. An excess coverage commercial insurance policy provides \$10,000,000 limit of liability in excess of a \$5,000,000 aggregate retention, which is satisfied by payment of losses under the Plans.

Rolling Owner Controlled Insurance Program (ROCIP)—The ROCIP was established for the centralized purchase of construction contractor insurance on various capital projects. This program provides workers’ compensation and general liability insurance for all contractors enrolled on projects participating in the program. The insurance carries a \$250,000 per claim and a \$375,000 per occurrence cash deductible, which is paid through the program’s self-insurance fund.

Automobile, Property, & Liability Plan—The Automobile, Property, & Liability Plan provides automobile liability and physical damage coverage for owned, leased, hired, and non-owned (excess liability only) vehicles, along with general liability coverage for certain scheduled exposures. All coverages are subject to a self-insured retention of \$2,500 for liability claims and \$1,000 for physical damage claims, subject to an aggregate stop loss deductible per policy term.

6. OPERATING LEASES

UTSW leases facilities under operating leases. Renewal and purchase options are available on certain of these leases. As of August 31, 2020, future minimum rental payments applicable to the operating leases were as follows (in thousands):

Years Ending August 31,	
2021	\$ 8,408
2022	7,874
2023	7,219
2024	6,621
2025	5,938
2026 - 2031	<u>16,950</u>
Total minimum future payments	<u>\$ 53,010</u>

Rental expense for all operating leases was approximately \$18,970,064 and \$11,234,669 for the years ended August 31, 2020 and 2019, respectively.

7. POST-EMPLOYMENT HEALTH CARE AND LIFE INSURANCE BENEFITS

In addition to providing pension benefits, the State provides certain health and life insurance benefits for retired employees (OPEB), in accordance with State statutes. Employees may become eligible for the health and life insurance benefits as a retired employee if they meet certain age and service requirements as defined by the State. Similar benefits for active employees are provided through the same self-funded plan. For the years ended August 31, 2020 and 2019, the State and retiree contribution rates for the self-funded plan per full-time retired employee are shown in the following table. The retiree contributes any premium charged over and above the State contributions.

Level of Coverage	2020		2019	
	Employer	Retiree	Employer	Retiree
Retiree only	\$ 628.05	\$ -	\$ 598.14	\$ -
Retiree/Spouse	957.27	270.41	911.69	257.53
Retiree/Children	838.70	282.81	798.76	269.34
Retiree/Family	1,169.89	532.51	1,114.18	507.15

Plan Description and Funding Policy—OPEB are provided to UTSW’s retirees under the UT System Employee Group Insurance Program (EGIP). The EGIP is a single-employer defined benefit OPEB plan; however, due to the State statute requiring appropriations for funding the plan, the State is reporting a proportionate share. Chapter 1551 of the Texas Insurance Code, Sections 310 and 311, require that the State contribute to the cost of each participant’s insurance coverage. The funds are appropriated under the General Appropriations Act Higher Education Employees Group Insurance (HEGI) Contributions. The State’s proportion was 20.51 and 20.82 percent of the collective OPEB related liabilities, deferred outflows and inflows and expense based on HEGI contributions by the State to total contributions as of August 31, 2020 and 2019. UTSW’s proportion as of August 31, 2020 and 2019 was 13.13 percent and 12.90 percent.

UTSW and member contribution rates are determined annually by UT System based on the recommendations of the OEB staff and the consulting actuary. The contribution rates are determined based on the benefit and administrative costs expected to be incurred and (i) the funds appropriated and (ii) the funding policy established by the Texas Legislature in connection with benefits provided through the EGIP. UT System revises benefits when necessary to match expected benefit and administrative costs with available revenue. The plan is operated on a pay-as-you-go basis and no assets are accumulated in a trust that meets the criteria in paragraph 4 of GASB Statement No. 75.

Employees Covered by Benefit Terms—The benefits provided are discussed in Note 15. The authority under which the obligations of the plan members and the System are established and may be amended is Chapter 1601, *Texas Insurance Code*. At the respective valuation dates, the following employees were covered by the benefit terms:

	<u>Valuation Date</u>	
	<u>December 31, 2019</u>	<u>December 31, 2017</u>
a. Inactive employees or beneficiaries currently receiving benefit payments	30,057	27,597
b. Inactive employees entitled to but not yet receiving benefit payments	11,681	12,311
c. Active employees	<u>99,474</u>	<u>90,605</u>
d. Total	<u><u>141,212</u></u>	<u><u>130,513</u></u>

Total OPEB Liability—UTSW has elected to use a measurement date that is eight months in advance of the fiscal year end. UTSW’s proportionate share of the total OPEB liability of \$1,907,844,714, including a current portion of \$33,842,306 and a noncurrent portion of \$1,874,002,408, reported for the fiscal year ended August 31, 2020 was measured as of December 31, 2019 and was determined by an actuarial valuation as of that same date. UTSW proportionate share of the total OPEB liability of \$1,686,650,925, including a current portion of \$37,556,917 and a noncurrent portion of \$1,649,094,008, reported for the fiscal year ended August 31, 2019 was measured as of December 31, 2018 and was determined by an actuarial valuation as of December 31, 2017 and rolled forward twelve months to December 31, 2018.

Actuarial Assumptions and Other Inputs—The Total OPEB Liability as of December 31, 2019 was determined by an actuarial valuation as of that same date using the following actuarial assumptions, applied to all periods included in the measurement, unless otherwise specified:

Inflation	2.30%
Salary increases	3.05% to 9.05% (includes inflation)
Discount rate	2.74%
Healthcare cost trend rates	7.50% for CY22 decreasing 0.50% per year to 5.00% for CY27, then decreasing to 4.75% for CY28 and to an ultimate rate of 4.30% for CY29 and later years

Mortality

- a. Service Retirees, Survivors and other Inactive Members: Tables based on TRS experience with Ultimate MP Projection Scale from the year 2018.
- b. Disability Retirees: Tables based on TRS experience with Ultimate MP Projection Scale from the year 2018 using a 3-year set forward and minimum mortality rates of four per 100 male members and two per 100 female members.
- c. Active Members: Sex Distinct RP-2014 Employee Mortality multiplied by 90% with Ultimate MP Projection Scale from the year 2014.

Discount Rate

- a. For the fiscal year ended August 31, 2020: The discount rate used to measure the Total OPEB Liability as of December 31, 2019 was 2.74%. The discount rate used to determine the Total OPEB Liability as of December 31, 2018 was 4.10%.
- b. For the fiscal year ended August 31, 2019: The discount rate used to measure the Total OPEB Liability as of December 31, 2018 was 4.10%. The discount rate used to measure the Total OPEB Liability as of December 31, 2017 was 3.44%.
- c. Municipal Bond Rate: 2.74% as of December 31, 2019 and 4.10% as of December 31, 2018; the source of the municipal bond rate is the Bond Buyer Index of general obligation bonds with 20 years to maturity and mixed credit quality. In describing their index, the Bond Buyer notes that the bonds' average credit quality is roughly equivalent to Moody's Investors Service's Aa2 rating and Standard & Poor's Corp.'s AA.

Many of the actuarial assumptions used in this valuation were based on the results of an actuarial experience study performed by the TRS retirement plan actuary as of August 31, 2017.

The following assumptions or other inputs were changed since the previous measurement date:

- i. Demographic Assumptions

Assumed rates of retirement, disability, termination, and mortality and assumed salary increases have been updated to reflect assumptions adopted by the TRS Trustees since the last valuation date. These new assumptions were adopted to reflect an experience study on the TRS retirement plan performed by the TRS retirement plan actuary.

In addition, the following assumptions were updated to reflect recent plan experience and expected trends:

- Percentage of future male and female retirees assumed to be married and electing coverage for their spouse.
- The proportion of future retirees covering dependent children.
- Percentage of future retirees and future retiree spouses assumed to use tobacco.

- Percentage of retirees assumed to elect health coverage at retirement and remain covered until death.
- ii. Economic Assumptions
- Assumed Per Capita Health Benefit Costs and Health Benefit Cost and Retiree Contribution trends have been updated since the previous valuation to reflect recent health plan experience and its effects on short-term expectations.
 - The expenses directly related to the payment of EGIP health benefits have been updated since the previous valuation to reflect changes in vendors.
 - The Patient-Centered Outcome Research Institute (PCORI) fees payable under the ACA have been updated since the previous valuation to reflect IRS Notice 2020-44 published June 8, 2020.
 - Assumed inflation has been updated to reflect an assumption adopted by the TRS Trustees since the last valuation date. This new assumption was adopted to reflect an experience study on the TRS retirement plan performed by the TRS retirement plan actuary.
- iii. Other Inputs
- The discount rate was changed as a result of requirements by GASB Statement No. 75 to utilize the yield or index rate as of the measurement date for 20-year, tax-exempt general obligation municipal bonds rated AA/Aa (or equivalent) or higher.

As of the measurement date of December 31, 2019, no changes in benefit and eligibility provisions have occurred. Accordingly, the benefit and eligibility provisions used in this valuation have not been changed since the prior valuation.

Sensitivity of UTSW’s Proportionate Share of the Total OPEB Liability to Changes in the Discount Rate

	FY20		
	1% Decrease (1.74)%	Discount Rate (2.74)%	1% Increase (3.74)%
Total OPEB liability	<u>\$ 2,326,892,340</u>	<u>\$1,907,844,714</u>	<u>\$1,587,483,735</u>
	FY19		
	1% Decrease (3.10)%	Discount Rate (4.10)%	1% Increase (5.10)%
Total OPEB liability	<u>\$ 2,046,605,038</u>	<u>\$1,686,650,925</u>	<u>\$1,414,063,467</u>

Sensitivity of UTSW's Proportionate Share of the Total OPEB Liability to Changes in the Healthcare Cost Trend Rates

	FY20		
	1% Decrease	Healthcare Cost Trend Rates	1% Increase
Total OPEB liability	<u>\$1,557,586,948</u>	<u>\$1,907,844,714</u>	<u>\$2,380,226,950</u>

	FY19		
	1% Decrease	Healthcare Cost Trend Rates	1% Increase
Total OPEB liability	<u>\$1,401,689,095</u>	<u>\$1,686,650,925</u>	<u>\$2,065,184,791</u>

Healthcare Cost Trend Rates used for fiscal year 2020 are shown below:

Calendar Year	Healthcare Cost Trend Rates		
	1% Decrease		1% Increase
2022	6.50 %	7.50 %	8.50 %
2023	6.00	7.00	8.00
2024	5.50	6.50	7.50
2025	5.00	6.00	7.00
2026	4.50	5.50	6.50
2027	4.00	5.00	6.00
2028	3.75	4.75	5.75
2029 and beyond	3.30	4.30	5.30

Healthcare Cost Trend Rates used for fiscal year 2019 are shown below:

Fiscal Year	Healthcare Cost Trend Rates		
	1% Decrease		1% Increase
2019	6.00 %	7.00 %	8.00 %
2020	7.00	8.00	9.00
2021	6.50	7.50	8.50
2022	6.00	7.00	8.00
2023	5.50	6.50	7.50
2024	5.00	6.00	7.00
2025	4.50	5.50	6.50
2026	4.00	5.00	6.00
2027 & beyond	3.50	4.50	5.50

UTSW recognized OPEB expense of \$129,866,514 for the fiscal year ended August 31, 2020 and \$122,016,348 for the fiscal year ended August 31, 2019.

Changes in UT System's proportionate share of the Total OPEB liability are shown below:

	Increase (Decrease) in Total OPEB Liability	
	For Measurement Year from December 31, 2018 to December 31, 2019	For Measurement Year from December 31, 2017 to December 31, 2018
Balance at beginning of measurement year	<u>\$ 10,355,785,546</u>	<u>\$ 10,717,111,345</u>
Changes for the year:		
Service cost	471,785,731	548,093,347
Interest	442,516,885	394,480,742
Differences between expected and actual experience	(89,235,022)	0
Changes of assumptions or other inputs	478,407,758	(1,429,460,396)
Benefit payments (employer)	<u>(152,076,995)</u>	<u>(153,396,451)</u>
Net changes	<u>1,151,398,357</u>	<u>(640,282,758)</u>
Changes in proportional share	<u>41,561,977</u>	<u>278,956,959</u>
Balance at end of measurement year	<u>\$ 11,548,745,880</u>	<u>\$ 10,355,785,546</u>

The changes in the total OPEB liability, including both UT System's and the State's portion, are shown in the table below.

	Increase (Decrease) in Total OPEB Liability	
	For Measurement Year from December 31, 2018 to December 31,2019	For Measurement Year from December 31, 2017 to December 31,2018
Balance at beginning of measurement year	<u>\$ 13,079,603,132</u>	<u>\$ 13,888,295,465</u>
Changes for the year:		
Service cost	593,494,649	692,254,917
Interest	556,675,173	498,238,547
Differences between expected and actual experience	(112,225,426)	0
Changes of assumptions or other inputs	601,824,994	(1,805,442,436)
Benefit payments (employer)	<u>(191,309,054)</u>	<u>(193,743,361)</u>
Net changes	<u>1,448,460,336</u>	<u>(808,692,333)</u>
Balance at end of measurement year	<u>\$ 14,528,063,468</u>	<u>\$ 13,079,603,132</u>

At each fiscal year-end, UTSW reported deferred outflows of resources and deferred inflows of resources related to OPEB from the sources listed in the table below.

	As of August 31, 2020		As of August 31, 2019	
	Deferred Outflows of Resources	Deferred Inflows of Resources	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	\$	\$ 27,257,937	\$ -	\$ 16,959,282
Changes of assumptions or other inputs	69,590,257	290,880,673		335,210,822
Change in proportion and contribution difference	143,821,939		136,040,416	
Contributions subsequent to the measurement date	<u>16,405,156</u>	<u></u>	<u>18,130,365</u>	<u></u>
	<u>\$ 229,817,352</u>	<u>\$ 318,138,610</u>	<u>\$ 154,170,781</u>	<u>\$ 352,170,104</u>

Amounts reported as Deferred Outflows/(Inflows) of Resources will be recognized in OPEB expense as follows:

For the Fiscal Year ended August 31, 2020:

Fiscal Year Ending August 31	Reduction of OPEB expense
2021	\$ (21,453,732)
2022	(21,453,732)
2023	(21,453,732)
2024	(21,453,732)
2025	(16,866,812)
Thereafter	<u>(2,044,673)</u>
Total	<u>\$ (104,726,413)</u>

8. RETIREMENT PLANS

TRS—The State of Texas (the “State”) has a joint contributory retirement plans for substantially all of its employees. The primary plan that UTSW participates in is a cost-sharing multiemployer public employee retirement system administered by TRS. TRS is primarily funded through state and employee contributions. Depending upon the source of funding for a participant’s salary, UTSW may be required to make contributions in lieu of the State.

All UTSW personnel employed in a position on a half time or greater basis for at least 4½ months or more are eligible for membership in TRS retirement plan. However, students employed in positions that require student status as a condition of employment do not participate. Members with at least five years of service have a vested right to unreduced retirement benefits at age 65, or provided they have a combination of age plus years of service totaling 80 or more. However, members who began TRS participation on or after September 1, 2007 must be age 60 to retire with unreduced benefits and

members who are not vested in TRS on August 31, 2014 must be age 62 to retire with unreduced benefits under the second option. Members are fully vested after five years of service and are entitled to any reduced benefits for which the eligibility requirements have been met prior to meeting the eligibility requirements for unreduced benefits.

The TRS Plan provides retirement, disability annuities, and death and survivor benefits. The benefit and contribution provisions of the TRS Plan are authorized by state law and may be amended by the Legislature. The pension benefit formulas are based on members' average annual compensation and years of service credit. The standard annuity is 2.3% of the average of the five highest annual salaries multiplied by years of service credit. For grandfathered members who were hired on or before August 31, 2005 and meet certain criteria, the standard annuity is based on the average of the three highest annual salaries. The plan does not provide automatic cost of living adjustments.

TRS contribution rates for both employers and employees are not actuarially determined, but are legally established by the State legislature. Contributions by employees were 7.7 percent of gross earnings for 2020 and 2019. Depending upon the source of funding for the employee's compensation, the State or UTSW contributes a percentage of participant salaries totaling 7.5 percent of annual compensation for 2020 and 6.8 percent of annual compensation for 2019. UTSW's actual contributions excluding the State match to TRS previously reported for the years ended August 31, 2020 and 2019 were \$72,162,162 and \$58,361,796, respectively.

The total pension liability is determined by an annual actuarial valuation. The tables below present the actuarial methods and assumptions used to measure the total pension liability as of the August 31, 2019 and August 31, 2018 measurement dates.

Summary of Actuarial Methods and Assumptions* – TRS Plan	
Actuarial Valuation Date	August 31, 2018 rolled forward to August 31, 2019
Actuarial Cost Method	Individual Entry Age Normal
Amortization Method	Level Percentage of Payroll, Floating
Asset Valuation Method	Market Value
Actuarial Assumptions:	
Discount Rate	7.25%
Investment Rate of Return	7.25%
Long-term Expected Rate of Return	7.25%
Municipal Bond Rate as of August 2019	2.63%**
Inflation	2.30%
Salary Increase	3.05% to 9.05% including inflation
Payroll Growth Rate	3.00%
Mortality:	
Active	90% of the RP 2014 Employee Mortality Tables for males and females with full generational mortality
Post-Retirement	2018 TRS Healthy Pensioner Mortality Tables with full generation projection using Scale U-MP
Ad Hoc Post-Employment Benefit Changes	None

Summary of Actuarial Methods and Assumptions* – TRS Plan	
Actuarial Valuation Date	August 31, 2017 rolled forward to August 31, 2018
Actuarial Cost Method	Individual Entry Age Normal

Amortization Method	Level Percentage of Payroll, Floating
Asset Valuation Method	Market Value
Actuarial Assumptions:	
Discount Rate	6.907%
Investment Rate of Return	8.00%
Long-term Expected Rate of Return	7.25%
Municipal Bond Rate as of August 2018	3.69%**
Inflation	2.30%
Salary Increase	3.05% to 9.05% including inflation
Payroll Growth Rate	2.50%
Mortality:	
Active	90% of the RP 2014 Employee Mortality Tables for males and females with full generational mortality using Scale BB
Post-Retirement	2018 TRS Healthy Pensioner Mortality Tables with full generation projection using Scale BB
Ad Hoc Post-Employment Benefit Changes	None

Notes:

*The assumptions used to determine the ADC are those in effect for the August 31, 2018 and August 31, 2017 actuarial valuations. Due to the lag between valuation data and the measurement date, they may not be the same assumptions used to measure the Net Pension Liability.

**Source for the rate is the Fixed Income Market Data/Yield Curve/Data Municipal Bonds with 20 years to maturity that include only federally tax-exempt municipal bonds as reported in Fidelity Index's "20-Year Municipal GO AA Index."

The actuarial assumptions used in the valuation were primarily based on the result of an actuarial experience study for the three-year period ending August 31, 2017 and adopted July 2018. The mortality rates were based on 90% of the RP 2014 employee Mortality Tables for males and females. The post-retirement mortality rates were based on the 2018 TRS Healthy Pensioner Mortality Tables.

The actuarial assumptions used in the determination of the total pension liability are the same assumptions used in the actuarial valuation as of August 31, 2018, except for a change in the following assumptions:

- the single discount rate as of August 31, 2018 was a blended rate of 6.907%, changed to the long term rate of return of 7.25% as of August 31, 2019; and,
- the enactment of Senate Bill 3 by the 2019 Legislature impacted future salaries by giving eligible active members a \$2,700 increase in fiscal year 2020 in addition to the salary increases expected.

There have been no changes to the benefit provisions of the plan since the prior measurement date.

The discount rate of 7.25% was applied to measure the total pension liability. The discount rate was based on the expected rate of return on pension plan investments of 7.25%. The projected cash flows into and out of the pension plan assumed that active members, employers, and non-employer contributing entity make their contributions at the statutorily required rates. It is assumed that future employer and State contributions will be 8.50% of payroll for the measurement period ending August 31, 2020, gradually increasing to 9.55% over the next several years. This includes a factor for all employer and State contributions for active and rehired retirees. Based on these assumptions, the

pension plan’s fiduciary net position and future contributions were sufficient to finance the benefit payments of current plan members. As a result, the long-term expected rate of return on pension plan investments was applied to all projected benefit payments to determine the total pension liability.

The long-term expected rate of return on plan investments was developed using a building-block method, in which best estimate ranges of expected future real rates of return (net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighing the expected future real rates of return by the target asset allocation percentage and by adding expected inflation.

The target allocation and best estimates of geometric real rates of return for each major asset class for the Plan’s investment portfolio as of August 31, 2019 measurement date are presented below:

Asset Class	Target Allocation	Long-Term Expected Geometric Real Rate of Return
Global equity:		
U.S.	18 %	6.40 %
Non-US developed	13	6.30
Emerging markets	9	7.30
Private equity	14	8.40
Stable value:		
U.S. treasury	16	3.10
Stable value hedge funds	5	4.50
Real return:		
Real assets	15	8.50
Energy and natural resources & InFrastructure	6	7.30
Risk parity—risk parity		
Risk Parity	8	5.80/6.50
Asset Allocation Leverage Cash	2	2.50
Asset Allocation Leverage	<u>(6)</u>	2.70
Total	<u><u>100 %</u></u>	

The target allocation and best estimates of arithmetic real rates of return for each major asset class for the plan's investment portfolio as of the August 31, 2018 measurement date are presented below:

Asset Class	Target Allocation	Long-Term Expected Arithmetic Real Rate of Return
Global equity:		
U.S.	18 %	5.7 %
Non-US developed	13	6.90
Emerging markets	9	8.95
Directional hedge funds	4	3.53
Private equity	13	10.18
Stable value:		
U.S. treasury	11	1.11
Absolute return		
Stable value hedge funds	4	3.09
Cash	1	(0.30)
Real return:		
Global inflation linked bonds	3	0.70
Real assets	14	5.21
Energy and natural resources	5	7.48
Commodities		
Risk parity—risk parity	<u>5</u>	<u>3.70</u>
Total	<u>100 %</u>	

Sensitivity analysis was performed on the impact of changes in the discount rate on the proportionate share of UTSW's net pension liability. The result of the analysis is presented in the table below:

**Sensitivity of UTSW's Proportionate Share of the Net Pension Liability
to Changes in the Discount Rate 2020**

1% Decrease (6.25%)	Current Discount Rate (7.25%)	1% Increase (8.25%)
<u>\$1,332,674,204</u>	<u>\$ 866,979,999</u>	<u>\$ 489,677,805</u>

**Sensitivity of UTSW's Proportionate Share of the Net Pension Liability
to Changes in the Discount Rate 2019**

1% Decrease (5.907%)	Current Discount Rate (6.907%)	1% Increase (7.907%)
<u>\$ 1,430,072,976</u>	<u>\$ 947,545,237</u>	<u>\$ 556,910,415</u>

The pension plan's fiduciary net position is determined using economic resources measurement focus and the accrual basis of accounting, which is the same basis used by TRS. Benefits and refunds of contributions are recognized when due and payable in accordance with the terms of the plan. Investments are reported at fair value. Fair value is a market-based measurement, not an entity-specific measurement. TRS utilizes one or more of the following valuation techniques in order to measure fair value: the market approach, the cost approach, and the income approach. More detailed information on the plan's investment policy, assets, and fiduciary net position may be obtained from TRS' fiscal 2019 Comprehensive Annual Financial Report. Further information regarding actuarial assumptions and conclusions, together with audited financial statements are included in the TRS' annual financial report, which may be obtained from the Teacher Retirement System of Texas, 1000 Red River Street, Austin, Texas 78701 or found on the TRS website at www.trs.state.tx.us.

As of August 31, 2020 and 2019, respectively, UTSW reported a liability of \$866,979,999 and \$947,545,238 for its proportionate share of the collective net pension liability. The collective net pension liability was measured as of August 31, 2019 and 2018, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of August 31, 2018 and 2017, respectively, and rolled forward to the measurement date UTSW's proportion as of the August 31, 2020 and 2019 was 1.66781% and 1.72148%, respectively. UTSW's proportion of the collective net pension liability was based on its contributions to the pension plan relative to the contributions of all employers and non-employer contributing entities to the plan for the periods September 1, 2018 through August 31, 2019 and September 1, 2017 through August 31, 2018. At August 31, 2020 and 2019, respectively, the amount of the net pension liability related to UTSW reported by the State was \$364,435,643 and \$261,094,766.

The amount reported by the State is related to the on-behalf contributions, which are recognized as State appropriation general revenue on UTSW's financial statements in the fiscal year that the State contributed the amounts to TRS on UTSW's behalf.

For the years ended August 31, 2020 and 2019, UTSW recognized pension expense of \$166,517,360 and \$124,766,054, respectively. At August 31, 2020 and 2019, UTSW reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	2020	
	Deferred Outflows of Resources	Deferred Inflow of Resources
Difference between expected and actual experience	\$ 3,642,092	\$ 30,102,921
Changes of assumptions	268,979,774	111,155,168
Net difference between projected and actual investment return	8,705,479	
Change in proportion and contribution difference	81,020,235	26,166,417
Contributions subsequent to the measurement date	72,162,162	
	<hr/>	<hr/>
Total	<u>\$ 434,509,742</u>	<u>\$ 167,424,506</u>

	2019	
	Deferred Outflows of Resources	Deferred Inflow of Resources
Difference between expected and actual experience	\$ 5,906,219	\$ 23,249,018
Changes of assumptions	341,635,699	10,676,124
Net difference between projected and actual investment return		17,978,993
Change in proportion and contribution difference	101,795,504	13,802,990
Contributions subsequent to the measurement date	<u>58,361,797</u>	
Total	<u>\$ 507,699,219</u>	<u>\$ 65,707,125</u>

The \$72,162,162 and \$58,361,797 reported as deferred outflows of resources resulting from contributions subsequent to the measurement date will be recognized as a reduction in the net pension liability for the year ending August 31, 2021 and 2020, respectively.

Other amounts reported as deferred outflows and inflows of resources related to pensions as of August 31, 2020 will be recognized in pension expense in the following years:

Fiscal Years	(Reduction) Increase of Pension Expense
2021	\$ 38,706,813
2022	31,087,585
2023	62,146,891
2024	54,424,358
2025	17,699,706
Thereafter	<u>(9,142,280)</u>
Total	<u>\$ 194,923,073</u>

Further information regarding actuarial assumptions and conclusions, together with audited financial statements, are included in the TRS' annual financial report, which may be obtained from the TRS, 1000 Red River Street, Austin, TX 78701 or found on the TRS website at www.trs.state.tx.us.

Optional Retirement Program (ORP)—The State has also established an ORP for institutions of higher education. Full-time faculty and certain staff members are eligible to participate in the ORP. Participation in the ORP is in lieu of participation in the TRS. The ORP provides for the purchase of annuity contracts and mutual funds. Participants are vested in the employer contributions after one year and one day of service. The contributory percentages of participant salaries currently provided by the state and each participant are 6.6% and 6.65%, respectively. Depending upon the source of funding for the employee's compensation, UTSW may be required to make the employer contributions in lieu of the State. UTSW may make contributions of up to an additional 1.9% of the employee's compensation. Since these are individual annuity contracts, the state and UTSW have no additional or unfunded liability for this program. UTSW's contribution for the years ended August 31, 2020 and 2019 was \$43,350,669 and \$40,624,443, respectively.

Employee contributions for the years ended August 31, 2020 and 2019 were \$33,996,972 and \$31,670,409, respectively.

9. BONDED INDEBTEDNESS

Short-Term Debt—UTSW receives proceeds from commercial paper and other short term debt issued and held by UT System to provide interim financing for capital improvements and to finance equipment purchases. These proceeds are evidenced through internal loan agreements and are recorded as transfers from UT System. UTSW disburses funds to UT System for payments of principal and interest related to UTSW’s internal loans. These disbursements are recorded as transfers to the UT System.

At August 31, 2020, UT System had outstanding Revenue Financing System (RFS) and Permanently University Fund (PUF) commercial paper notes payable of \$1,413,698,000. No amount of indebtedness related to these commercial paper notes has been recorded in UTSW’s financial statements, as the UT System is the party directly liable for these commercial paper notes. At August 31, 2020, however, UTSW’s remaining unpaid share of short-term internal loans was \$510,605,000.

Long Term Bond and Debt Service Requirements—UTSW receives proceeds from revenue bonds issued and held by UT System to support capital projects of the UT System and its institutions. These proceeds are evidenced through internal loan agreements and are recorded as transfers from UT System. UTSW disburses funds to UT System for payments of principal and interest related to UTSW’s share of bond proceeds internal loans. These disbursements are recorded as transfers to the UT System.

At August 31, 2020, UT System had outstanding RFS bonds payable of \$6,745,455,000. No amount of indebtedness related to these bonds has been recorded in UTSW’s consolidated financial statements, as the UT System is the party directly liable for these bonds. At August 31, 2020, however, UTSW’s remaining unpaid share of the bond proceeds long-term internal loans was \$954,532,000.

Debt service requirements at August 31, 2020 were as follows:

August 31	Principal	Interest	Total
2021	\$ 51,577	\$ 35,247	\$ 86,823
2022	54,325	33,222	87,546
2023	55,679	31,030	86,709
2024	57,954	28,737	86,691
2025	53,068	26,368	79,437
2026-2030	175,988	107,465	283,453
2031-2035	159,585	76,320	235,906
2036-2040	148,317	49,113	197,430
2041-2045	142,293	24,180	166,473
2046-2050	53,395	4,043	57,438
2051-2055	<u>2,351</u>	<u>59</u>	<u>2,410</u>
Total	<u>\$ 954,532</u>	<u>\$ 415,784</u>	<u>\$ 1,370,316</u>

UTSW has recorded a receivable, due from system, in the amount of \$25,024,079 and \$81,729,337 as of August 31, 2020 and 2019, respectively, of debt funds still to be received. Interest rates on UTSW's remaining unpaid share of RFS bonds range from 0.060% to 5.375%. A summary of interest cost for UTSW on borrowed funds held by UT System for the years ended August 31, 2020 and 2019, is as follows (in thousands):

	2020	2019
Interest cost:		
Charged to transfers	<u>\$ 41,708</u>	<u>\$ 40,322</u>
Total	<u>\$ 41,708</u>	<u>\$ 40,322</u>

10. ENDOWMENTS

Endowments—The net position classifications on the Statement of Net Position related to endowment funds, including annuity and life income funds, as of August 31, 2020 and 2019, were as follows (in thousands):

Net Position Classification of Endowments	2020	2019
Restricted—nonexpendable	\$ 1,016,704	\$ 694,634
Restricted—expendable:		
Net appreciation on true endowments	81,161	426,424
Funds functioning as endowments	485,584	59,451
Unrestricted—funds functioning as endowments	<u>55,908</u>	<u>35,470</u>
Total	<u>\$ 1,639,357</u>	<u>\$ 1,215,979</u>

In the table above, amounts reported as “net appreciation” represent net appreciation on investments of donor or constitutionally restricted endowments that are available for authorization for expenditure by the UT System Board of Regents. For donor-restricted endowments, pursuant to the Uniform Prudent Management of Institutional Funds Act, as adopted by Texas, the UT System Board of Regents may distribute net appreciation, realized and unrealized, in the fair market value of the assets of endowment holdings over the historic dollar value of the gifts, to the extent prudent. The UT System's policy is to retain all undistributed net realized and unrealized appreciation within the endowment funds. The UT System's endowment distribution policy is further discussed below.

These endowments are invested in the PHF and the General Endowment Fund (GEF). The balances in the PHF and GEF for UTSW at August 31, 2020 and 2019 were \$76,933,850 and \$73,412,250 and \$1,562,422,758 and \$1,142,566,492 respectively.

The UT System Board of Regents manages certain permanent funds for health-related institutions of higher education as more fully described in Chapter 63 of the Texas Education Code. Certain funds created by this statute were transferred to the UT System Board of Regents on August 30, 1999, to be managed and invested in the same manner as the UT System Board of Regents manages and invests other endowment funds. The PHF, as defined in the statute, is classified as Endowment and Similar Funds—State. These endowments provide support for programs that benefit medical research, health education, or treatment at health-related institutions.

The UT System Board of Regents determines the amount of distributions to support the programs based on the PHF's investment policy. The PHF's investment policy provides that the annual payout will be adjusted by the average consumer price index of the previous 12 quarters. However, if this inflationary increase results in a distribution rate below 3.5%, the UTIMCO board may recommend an increase in the distribution amount as long as such increase does not result in a distribution rate of more than 5.5%. If the distribution rate exceeds 5.5%, the board may recommend a reduction in the per unit distribution amount. Notwithstanding any of the forgoing provisions, the UT System Board of Regents may approve a per unit distribution amount that, in its judgment, would be more appropriate than the rate calculated by the policy provisions.

The GEF, created March 1, 2001, is a pooled fund established for the collective investment of LTFs under the control and management of the UT System Board of Regents. The GEF is organized as a pooled investment and has two participants, the PHF and the LTF. The PHF and LTF initially purchased units of the GEF on March 1, 2001, in exchange for the contribution of their investment assets. The GEF provides for greater diversification of investments than would be possible if each account were separately managed.

Endowment and Similar Funds—Funds subject to restrictions of endowment and trust instruments require that the principal be maintained and that only the income be utilized. Funds may include endowments, term endowments, and funds functioning as endowments. Funds functioning as endowments consist of amounts that have been internally dedicated by the UT System for long-term investment purposes. Funds with external donor restrictions are classified as Funds functioning as endowments—restricted. If no external restriction exists, the funds are classified as funds functioning as endowments—unrestricted.

11. CONCENTRATIONS OF PATIENT ACCOUNTS RECEIVABLE CREDIT RISK

UTSW grants credit without collateral to its patients. The mix of gross and net receivables from patients and third-party payors as of August 31, 2020 and 2019, is as follows:

	<u>Gross Receivables</u>		<u>Net Receivables</u>	
	<u>2020</u>	<u>2019</u>	<u>2020</u>	<u>2019</u>
Commercial insurance	1.5 %	1.7 %	1.4 %	1.3 %
Medicaid	6.3	7.0	3.3	3.6
Medicare	29.4	25.0	27.7	24.1
Managed care organizations	37.0	37.5	53.4	55.9
Others	20.2	24.6	12.2	13.5
Self-pay	<u>5.5</u>	<u>4.2</u>	<u>2.0</u>	<u>1.6</u>
Total	<u>100.0 %</u>	<u>100.0 %</u>	<u>100 %</u>	<u>100.0 %</u>

12. COMMITMENTS AND CONTINGENCIES

Pending Lawsuits and Claims—UTSW is involved in litigation and regulatory investigations arising in the ordinary course of business. After consultation with legal counsel, management believes that these matters will be resolved without material adverse effect on UTSW's financial position or results from operations. UTSW is not aware of any significant pending or threatened litigation involving allegations of potential wrongdoing.

Commitments for Construction—As of August 31, 2020 and 2019, the remaining commitment on construction contracts for expansion and remodeling of UTSW’s facilities is approximately \$352 million and \$283 million, respectively. A majority of these commitments is related to the ongoing construction of the comprehensive North Campus Phase 6 – Brain and Cancer Center.

Laws and Regulations—UTSW is subject to laws and regulations governing the Medicare and Medicaid programs, and certain other third-party programs that are complex and subject to interpretation. As a result, there is at least a reasonable possibility that the recorded estimates of third-party settlements will change by a material amount in the near term. UTSW’s intent is to be in compliance with all applicable laws and regulations. Compliance with such laws and regulations can be subject to future review and interpretations. Changes in Medicare and Medicaid programs and a reduction in funding could have an adverse effect on UTSW. Further, UTSW receives grants and other forms of reimbursement from various federal and state agencies. These activities are subject to audit by agents of the funding authority, the purpose of which is to ensure compliance with conditions precedent to providing such funds. UTSW believes that the liability, if any, for reimbursement, which may arise as the result of audits, would not be material.

13. RELATED PARTIES

Through the normal course of operations, UTSW both receives funds from and provides funds to other state agencies in support of sponsored programs. Funds received and provided during the year ended August 31, 2020, related to pass-through grants were approximately \$50,660,539 and \$3,664,987, respectively. Funds received and provided during the year ended August 31, 2019, related to pass-through grants were approximately \$50,050,492 and \$3,311,992, respectively.

UTSW also routinely enters into transactions with UT System for the reimbursement of capital outlay and other expenses. Amounts due from UT System were approximately \$31,479,770 and \$88,144,613 at August 31, 2020 and 2019, respectively. Amounts due to UT System were approximately \$21,030,697 and \$18,634,125 as of August 31, 2020 and 2019, respectively.

14. DEFERRED COMPENSATION PROGRAMS

UTSW offers two types of 457 deferred compensation plans (DCPs): a 457(b) plan and a 457(f) plan. The 457(b) plan is available to all employees and the 457(f) plan is limited to senior executives. The 457 plans are consistent with the Internal Revenue Code of 1986, as amended, and its regulations thereunder including, but not limited to, Section 457 (b) (f) thereof and Subchapter D, Chapter 609 of the Texas Government Code. The assets of DCPs do not belong to UTSW or UT System and, therefore, neither UT System nor UTSW has any liability under DCPs. It is unlikely that plan assets will be used to satisfy the claims of general creditors in the future.

Section 457(b) Deferrals—UTSW employees may elect to participate in the UTSaver DCP, a supplemental retirement program that allows participants to tax-defer additional income for retirement, through pretax contributions. Participants can contribute a minimum of \$15 per month or as much as 100% of eligible compensation up to \$19,000 if employee is aged 49 or younger, or \$25,000 if the employee is aged 50 or older for 2020 in the UTSaver DCP plan. The Plan is administered by UT System, which ensures compliance with applicable federal and state laws, and internal policies consistent with the UT System Board of Regents rules and regulations.

Section 457(f) Deferrals—UTSW has established a 457(f) DCP for a select group of individuals as identified by the president and with the approval of the executive vice chancellor for health affairs. The structure of the Plan allows for the deferral of compensation pursuant to Section 457 (f) of the Internal Revenue Code. The deferral agreements are for a minimum of three years and a maximum of five years. Deferrals are contributed to the participants established in 457(f) account on an annual basis. At the end of the deferral agreement period, provided the employee is still employed, he/she will become vested in the contributed amounts, including earnings and losses. It is at this time that the balance in the participant's account is considered as taxable income.

15. JOINT VENTURES

U.T. Southwestern Health Systems (UTSHS), a blended component unit of U.T. Southwestern Medical Center, is a participating member of U.T. Southwestern DVA Healthcare, LLP (DVA). DVA is a joint venture between UTSHS and DaVita Inc. to provide care for dialysis patients in the Dallas-Fort Worth area. UTSHS's equity interest in DVA at August 31, 2020 and 2019 was \$8,038,642 and \$10,597,069, respectively, or 49%. Separate financial statements for DaVita may be obtained at DaVita Inc., 2000 16th Street, Denver, CO, 80202 or www.DaVita.com.

UTSHS is a participating member of Crowder Dialysis, LLC (Crowder). Crowder is a joint venture between UTSHS, Crowder, and Renal Treatment Centers-Southeast, LP, formed for the purpose of developing, establishing, owning or leasing, and operating one or more licensed outpatient dialysis and renal care service centers and for the purpose of doing such other things as are necessary, convenient, desirable or incidental to the foregoing, and for such other purposes as may be agreed upon from time to time. UTSHS's equity interest in Crowder at August 31, 2020 and 2019 was \$1,065,212 and \$1,124,414, respectively, or 49%. Separate financial statements for Crowder may be obtained at c/o DaVita Inc., 2000 16th Street, Denver, Colorado, 80202 or www.DaVita.com.

On December 15, 2015, Texas Health Resources (THR) and The University of Texas Southwestern Medical Center (UTSW) formed an integrated regional health network through a Master Affiliation Agreement (MAA). The initial term of the MAA is twenty (20) years, beginning on the effective date of December 15, 2015. Unless one party to the agreement notifies the other party to the agreement by written termination notice at least three (3) years prior to the expiration of the first twenty (20) year initial term, the agreement will automatically extend for an additional ten-year period. The network, Southwestern Health Resources (SWHR), commenced activities on April 1, 2016 offering key advantages for patients in North Texas including: a) a broad, integrated continuum of physician-driven care utilizing UTSW's network of faculty and community-based physicians, THR's employed physicians, and independent physicians affiliated with both organizations; and b) an integrated hospital network consisting of UTSW's two university hospitals and THR's wholly-controlled and joint-ventured community hospitals, a key component of which is a new organization—a Joint Operating Company formed to centralize leadership of UTSW's University Hospital and THR's Texas Health Presbyterian Hospital Dallas) under a single Senior Executive Officer. UTSW and THR agreed to share in revenues and expenses between the joint operating company hospitals in accordance with an independent third party consultant's valuation that determined the adjusted earnings allocation percentage should be set at 46% for THR and 54% for UTSW. Though the agreement established a methodology by which revenues and expenses are shared through a monthly network settlement, UTSW and THR did not relinquish ownership of the individual hospitals. UTSW and THR continue to report their respective revenues and expenses generated by their respective hospitals. Accordingly, the MAA calls for a Network Settlement that is to be calculated no less frequently than annually and is to be paid no later than ninety (90) days after the end of the Hospitals JOC's fiscal year ending August 31st, based on the

difference between the sharing allocation percentages and the actual operating results of the three hospitals. For the fiscal years ended August 31, 2020 and 2019, UTSW recorded receivables of \$2.2 million and payables of \$16.1 million, respectively, based on the network settlement calculation.

The second amended and restated MAA dated September 1, 2018 between THR and UTSW created three (3) separate corporations, Southwestern Health Resources Clinically Integrated Network (CIN), Southwestern Health Resources Corp (SWHR) and Southwestern Health Resources Hospitals JOC (JOC).

The Southwestern Health Resources Clinically Integrated Network (CIN) is the sole member of Southwestern Health Resources Physician Network. The Southwestern Health Resources Physician Network is the sole member of NTSP Holding Company, LLC and Southwestern Health Resources Accountable Care Network.

The purpose of Southwestern Health Resources Clinically Integrated Network (CIN) is to be responsible for approving the strategic plans and Capital and Operating Budgets of the Southwestern Health Resources Physician Network, Southwestern Health Resources Accountable Care Network and NTSP Entities. Membership interest in Southwestern Health Resources Clinically Integrated Network (CIN) is 51% UTSW and 49% THR.

The purpose of SWHR is to further the longstanding and complementary commitments and missions of UTSW and THR, provide support to Texas Health Presbyterian Hospital Dallas, William P. Clements Jr. University Hospital, and other tax- exempt hospitals associated with THR, and to provide support to one or more tax-exempt physician groups that are wholly controlled by either UTSW or THR. Membership interest in SWHR is 50% UTSW and 50% THR.

The purpose of the JOC is to further the longstanding and complementary commitments and missions of UTSW and THR, participate in a clinically integrated network of physicians, hospitals, and other care providers, operate and provide support to Texas Health Presbyterian Hospital Dallas, William P. Clements Jr. University Hospital, and other tax-exempt hospitals associated with THR, and engage in such other health care related activities as may be necessary. Membership interest in the JOC is 49% UTSW and 51% THR.

All three (3) entities, CIN, SWHR, and JOC created by the MAA are legally separate entities that are jointly owned, operated, and each are governed by both UTSW and THR as a separate and specific activity subject to joint control. Neither UTSW nor THR has the ability to unilaterally control the financial or operating policies of the joint ventures. UTSW's combined financial interest in all of the aforementioned legal entities as of August 31, 2020 and 2019 was \$50,087,388 and \$28,803,625 or approximately 50% for both years.

On August 28, 2018, THR and UTSW signed a Members Agreement to form Texas Health Hospital Frisco (THHF) to provide health care for the patient population residing in Frisco, Texas and surrounding communities. This will enhance UTSW's ability to conduct research and expand educational activities with exposure to all dimensions of care delivery necessary in the aggregate for an entire community.

UTSW's financial interest in THHF as of August 31, 2020 and 2019 was 100,635,710 and \$105,046,823.

UTSW is a participating member of Pediatric Health Management Services. Pediatric Health Management Services is a joint venture entered into by UTSW and Children's Health System of Texas on October 1, 2019. UTSW's equity interest in Pediatric Health Management Services at August 31, 2020 was 50%, however there were no financial transactions in fiscal year 2020.

16. UNCONDITIONAL PROMISES TO GIVE

Contributions received from donors resulting from non-exchange transactions are recorded as revenues when all the eligibility requirements are met. Restricted contributions are recorded as restricted net assets if they are received with donor stipulations that limit the use or the timing of the donated asset.

Unconditional promises to give are recorded when the gift intent is made known in writing. A receivable has been established and net position has been increased by the time-discounted value of the promises. During the fiscal years ended August 31, 2020 and 2019, discount rates used ranged from 1.70% to 1.91% and 2.49% to 3.07% respectively. Irrevocable trusts are recorded at the point of notification and are recorded as restricted—expendable or restricted—nonexpendable as determined by the trust instruments. The anticipated present value of the contributions receivable as of August 31, 2020 and 2019, is as follows (in thousands):

	2020	2019
Due in one year	\$ 11,165	\$ 19,315
Due in two to five years	<u>25,444</u>	<u>35,074</u>
Gross contributions receivable	36,609	54,389
Less present value discount of gross contributions	<u>(2,184)</u>	<u>(3,124)</u>
Net contributions receivable	<u>\$ 34,425</u>	<u>\$ 51,265</u>

The net contributions receivable balance as of August 31, 2020 and 2019 includes approximately \$6.2 million and \$7.7 million respectively of anticipated capital contributions for construction of the William P. Clements Jr. Hospital and other capital projects. On the Consolidated Statements of Net Position, these amounts are included in the noncurrent portion of contributions receivable because they are restricted for capital assets.

As of August 31, 2020 and 2019, UTSW had received conditional promises to give and indications of intentions to give of approximately \$48 million and \$3.5 million, respectively, in addition to the amounts recorded as contributions receivable. These amounts are not reflected in the accompanying consolidated financial statements.

17. FACULTY INCENTIVE PLANS

Incentive compensation may be paid to a medical service research development plan faculty member to promote future performance. The amount of such payment is determined through established and equitably applied formulas set forth in the departmental incentive plans. Incentive compensation is not guaranteed or fixed. To be eligible to receive incentive compensation, a faculty member must be a UTSW employee on the date the payment is made.

18. UPCOMING ACCOUNTING PRONOUNCEMENTS

GASB Statement No. 87, *Leases*, effective 2022, establishes a single model for lease accounting. UTSW is evaluating the effect that Statement No. 87 will have on its financial statements.

GASB Statement No. 91, *Conduit Debt Obligations*, effective 2023, provides a single method of reporting conduit debt obligations. UTSW is in the process of researching the effect that Statement No. 91 will have on the financial statements.

GASB Statement No. 92, *Omnibus 2020*, effective 2022, enhances comparability. UTSW is in the process of researching the effect that Statement No. 92 will have on the financial statements.

GASB Statement No. 93, *Replacement of Interbank Offered Rates*, effective 2022, preserves consistency and comparability of reporting hedging derivative instruments and leases after agreements are amended to replace LIBOR. UTSW is in the process of researching the effect that Statement No. 93 will have on our financial statements.

GASB Statement No. 94, *Public-Private and Public-Public Partnerships and Availability Payment Arrangements*, effective 2023, improves financial reporting by addressing issues related to public-private and public-public partnership arrangements. UTSW is in the process of researching the effect that Statement No. 94 will have on our financial statements.

GASB Statement No. 96, *Subscription-Based Information Technology Arrangements (SBITA)*, effective 2023, establishes that a SBITA results in a right-to-use subscription asset—an intangible asset—and a corresponding subscription liability, provides the capitalization criteria for outlays other than subscription payments, including implementation costs of a SBITA, and requires note disclosures regarding a SBITA. UTSW is in the process of researching the effect that Statement No. 96 will have on the financial statements.

Other than the portion of this statement implemented in 2020, the remainder of GASB Statement No. 97, *Certain Component Unit Criteria, and Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans*, which becomes effective in 2022, provides guidance for the accounting and financial reporting for Section 457 plans (defined benefit plans vs. defined contribution plans), and for all other arrangements, clarifies that for purposes of determining whether a primary government is financially accountable for a potential component unit, the absence of a governing board be treated the same as the appointment of a voting majority of a governing board if the primary government performs the duties that a governing board typically would perform. UTSW is in the process of researching the effect that Statement No. 97 will have on the financial statements.

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REQUIRED SUPPLEMENTARY INFORMATION (UNAUDITED)

UT SOUTHWESTERN MEDICAL CENTER

**REQUIRED SUPPLEMENTARY INFORMATION OTHER
POST EMPLOYMENT BENEFITS PLAN AUGUST 31, 2020
SCHEDULE OF THE UTSW'S PROPORTIONATE SHARE OF THE TOTAL OPEB LIABILITY
AS OF THE DECEMBER 31 MEASUREMENT DATE**

	2019	2018	2017	2016
UTSW's proportion of the total OPEB liability	13.13 %	12.90 %	11.53 %	12.38 %
UTSW's proportionate share of the total OPEB liability	\$ 1,907,844,714	\$ 1,686,650,925	\$ 1,720,054,323	\$ 1,669,316,788
State's proportionate share of the total OPEB liability related to UTSW	<u>219,884,837</u>	<u>\$ 201,030,020</u>	<u>\$ 239,846,946</u>	<u>\$ 244,590,540</u>
Total OPEB liability related to UTSW	<u>\$ 2,127,729,551</u>	<u>\$ 1,887,680,945</u>	<u>\$ 1,959,901,269</u>	<u>\$ 1,913,907,328</u>
UTSW's covered payroll	<u>\$ 1,031,671,829</u>	<u>\$ 931,517,973</u>	<u>\$ 888,629,758</u>	<u>\$ 858,104,280</u>
UTSW's proportionate share of the total OPEB liability as a percentage of its covered payroll	184.93 %	181.06 %	193.56 %	194.54 %
Plan fiduciary net position as a percentage of the total OPEB liability	- %	- %	- %	- %

Only four years of information is presented due to GASB Statement 75 being implemented in 2017. Additional years will be displayed as they become available

UT SOUTHWESTERN MEDICAL CENTER

REQUIRED SUPPLEMENTARY INFORMATION TEACHER RETIREMENT SYSTEM PENSION PLAN AUGUST 31, 2020

Schedule of UTSW's Proportionate Share of the Net Pension Liability as of the August 31, 2019, Measurement Date					
	2019	2018	2017	2016	2015
UTSW's proportion of the net pension liability	1.66781 %	1.72148 %	1.52801 %	1.44082 %	1.30157 %
UTSW's proportionate share of the net pension liability	\$ 866,980	\$ 947,545	\$ 488,575	\$ 544,466	\$ 460,089
States's proportionate share of the net pension liability related to UTSW	<u>364,436</u>	<u>261,095</u>	<u>164,996</u>	<u>155,176</u>	<u>131,829</u>
Total net pension liability related to UTSW	<u>\$ 1,231,416</u>	<u>\$ 1,208,640</u>	<u>\$ 653,571</u>	<u>\$ 699,642</u>	<u>\$ 591,918</u>
UTSW's covered payroll	<u>\$ 933,809</u>	<u>\$ 851,568</u>	<u>\$ 803,043</u>	<u>\$ 738,927</u>	<u>\$ 690,965</u>
UTSW's proportionate share of the net pension liability as a percentage of its covered payroll	92.84 %	111.27 %	60.84 %	73.68 %	66.59 %
TRS Plan fiduciary net position as a percentage of the total pension liability	75.24 %	73.74 %	82.17 %	78.00 %	78.43 %

Schedule of UTSW's Contributions as of August 31st					
For the Year Ended August 31,					
	2020	2019	2018	2017	2016
Statutorily required contributions	\$ 78,342	\$ 63,499	\$ 57,907	\$ 54,606	\$ 50,247
Contributions in relation to the statutorily required contributions	<u>72,162</u>	<u>58,362</u>	<u>52,806</u>	<u>50,079</u>	<u>45,779</u>
Contribution deficiency	<u>\$ 6,180</u>	<u>\$ 5,137</u>	<u>\$ 5,101</u>	<u>\$ 4,527</u>	<u>\$ 4,468</u>
UTSW's covered payroll	<u>\$ 1,044,563</u>	<u>\$ 933,809</u>	<u>\$ 851,569</u>	<u>\$ 803,043</u>	<u>\$ 738,927</u>
Contributions as a percentage of covered payroll	6.91 %	6.25 %	6.20 %	6.24 %	6.20 %

Contributions by the State of Texas on behalf of UTSW substantially resolve the contribution deficiency.

Only five years of information is presented due to GASB Statement 68 being implemented in 2015. Additional years will be displayed as they become available.

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

To the Members of the Audit, Compliance, and Management Review Committee of The University of Texas System Board of Regents

We have audited, in accordance with the 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 consolidated financial statements of The University of Texas Southwestern Medical Center ("UTSW") which comprise the consolidated statement of net position as of August 31, 2020, and the related consolidated statements of revenues, expenses, and

changes in net position, and cash flows for the year then ended, and the related notes to the consolidated financial statements, which collectively comprise UTSW's consolidated financial statements, and have issued our report thereon dated December 10, 2020.

Internal Control Over Financial Reporting

In planning and performing our audit of the consolidated financial statements, we considered UTSW's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of UTSW's internal control. Accordingly, we do not express an opinion on the effectiveness of UTSW'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 UTSW's consolidated financial statements will not be prevented or detected and corrected on a timely basis. *A significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether UTSW's consolidated financial statements are free from 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 financial statements. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

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

Deloitte & Touche LLP

December 10, 2020