

Combined Financial Statements

**HARRIS COUNTY HOSPITAL DISTRICT AND AFFILIATE, A COMPONENT UNIT OF
HARRIS COUNTY, TEXAS, INCLUDING OTHER REPORTS RELATED TO STATE OF
TEXAS SINGLE AUDIT CIRCULAR**

Years ended February 29, 2000 and February 28, 1999

Harris County Hospital District and Affiliate, a
Component Unit of Harris County, Texas

Combined Financial Statements

Years ended February 29, 2000 and February 28, 1999

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Report of Independent Auditors

Board of Managers
Harris County Hospital District

We have audited the accompanying combined balance sheets of the Harris County Hospital District and Affiliate (the "District"), a discretely presented component unit of Harris County, Texas, as of February 29, 2000 and February 28, 1999, and the related combined statement of operations, changes in fund balances, and cash flows for the years then ended. These financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards and *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 combined financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the combined financial position of the Harris County Hospital District, and Affiliate at February 29, 2000 and February 28, 1999, and the combined results of their operations and their cash flows for the years then ended in conformity with generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have issued a report dated May 26, 2000, on our consideration of the District's internal control over financial reporting and on its compliance with applicable laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The accompanying Schedule of Expenditures of State Awards is presented for purposes of additional analysis as required by the State of Texas Single Audit Circular and is not a required part of the combined financial statements. Such information has been subjected to the auditing procedures applied in the audit of the combined financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the combined financial statements taken as a whole.

May 26, 2000

Ernst + Young LLP

Harris County Hospital District and Affiliate, a
Component Unit of Harris County, Texas

Combined Balance Sheets

	February 29 2000	February 28 1999
<i>(In Thousands)</i>		
Assets		
Current assets:		
Cash and cash equivalents	\$ 38,240	\$ 64,374
Short-term investments	121,747	140,823
Accounts receivable, net of allowance for uncollectible accounts of \$148,439 in 2000 and \$148,666 in 1999	40,343	37,105
Current portion of ad valorem taxes receivable, net of allowance for uncollectible taxes of \$2,067 in 2000 and \$987 in 1999	11,313	6,432
Inventories	2,863	2,858
Prepaid expenses and other current assets	8,264	5,020
Current portion of assets limited as to use <i>(Note 6)</i>	16,422	14,445
Total current assets	239,192	271,057
Assets limited as to use or restricted, net of current portion <i>(Note 6)</i> :		
Debt service	70,116	34,341
Future indigent care (Disproportionate Share III) <i>(Note 4)</i>	-	89,542
Other	1,744	1,802
	71,860	125,685
Property, plant, and equipment:		
Buildings and fixed equipment	236,675	247,183
Major movable equipment	137,429	118,937
Less accumulated depreciation	(222,550)	(220,876)
	151,554	145,244
Land and land improvements	11,172	11,380
Construction in progress	4,751	6,488
	167,477	163,112
Other assets:		
Ad valorem taxes receivable, net of current portion and allowance for uncollectible taxes of \$45,999 in 2000 and \$35,411 in 1999	4,201	14,841
Deferred bond issue costs, net of accumulated amortization of \$4,666 in 2000 and \$4,281 in 1999	1,941	2,326
	6,142	17,167
Total assets	\$ 484,671	\$ 577,021

Harris County Hospital District and Affiliate, a
Component Unit of Harris County, Texas

Combined Balance Sheets (continued)

	February 29 2000	February 28 1999
<i>(In Thousands)</i>		
Liabilities and fund balances		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 46,168	\$ 41,438
Bond interest payable	3,071	2,894
Employee compensation and related benefit liabilities	9,699	8,015
Vacation and sick leave benefits	9,734	8,970
Estimated third-party payor settlements	6,369	10,260
Current portion of long-term debt	13,351	11,551
Total current liabilities	88,392	83,128
Long-term debt:		
Revenue bonds, net of discount of \$1,309 in 2000 and \$1,524 in 1999 <i>(Note 5)</i>	135,409	149,008
Fund balances:		
Unrestricted	259,126	253,541
Restricted:		
Specific-purpose funds	1,744	1,802
Future indigent care (Disproportionate Share III) <i>(Note 4)</i>	-	89,542
Total fund balances	260,870	344,885
Commitments and contingencies <i>(Note 12)</i>		

Total liabilities and fund balances	\$ 484,671	\$ 577,021
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See accompanying notes.

Harris County Hospital District and Affiliate, a
Component Unit of Harris County, Texas

Combined Statements of Operations

	Year ended	
	February 29, 2000	February 28, 1999
	<i>(In Thousands)</i>	
Net patient service revenues <i>(Note 3)</i>	\$ 291,477	\$ 353,382
Disproportionate Share III <i>(Note 4)</i>	146,509	146,978
Net ad valorem tax revenues	197,955	159,275
Net tobacco settlement revenue	–	45,772
Premium revenues	41,733	34,891
Other operating revenues	21,165	31,536
Total revenues	698,839	771,834
Operating expenses:		
Salaries and employee benefits	247,245	218,260
Pharmaceuticals and supplies	97,337	90,671
Physician services	70,024	54,677
Medical claims expense	38,418	32,437
Other purchased services	61,974	51,330
Provision for bad debt expense	144,347	218,620
Depreciation and amortization	21,660	22,914
Interest	12,249	12,864
Total operating expenses	693,254	701,773
Operating income	\$ 5,585	\$ 70,061

See accompanying notes.

Harris County Hospital District and Affiliate, a
Component Unit of Harris County, Texas

Combined Statements of Changes in Fund Balances

	Year ended February 29, 2000				Year ended February 28, 1999			
	Unrestricted Fund Balance	Specific- Purpose Fund Balance	Future Indigent Care (Note 4)	Total	Unrestricted Fund Balance	Specific- Purpose Fund Balance	Future Indigent Care (Note 4)	Total
	<i>(In Thousands)</i>				<i>(In Thousands)</i>			
Balances at beginning of year – As Previously Reported	\$ 253,541	\$ 1,802	\$ 89,542	\$ 344,885	\$ 178,960	\$ 2,565	\$ 150,316	\$ 331,841
Cumulative effect of change in accounting principle (Note 6)	–	–	–	–	4,805	–	4,934	9,739
Balances at beginning of year – As Restated	253,541	1,802	89,542	344,885	183,765	2,565	155,250	341,580
Additions:								
Operating income (Note 6)	5,585	–	–	5,585	69,776	–	285	70,061
Gifts, grants, and bequests	–	259	–	259	–	314	–	314
Investment income	–	86	–	86	–	104	–	104
Increase in fair value of investments	–	14	–	14	–	–	–	–
Federal funds received to provide indigent care	–	–	60,270	60,270	–	–	80,985	80,985
	5,585	359	60,270	66,214	69,776	418	81,270	151,464
Deductions:								
Transfer to other operating revenue	–	(417)	–	(417)	–	(478)	–	(478)
Transfer to Disproportionate Share III revenue	–	–	(146,509)	(146,509)	–	–	(146,978)	(146,978)
Decrease in fair value of investments	–	–	(3,303)	(3,303)	–	–	–	–
Transfer of assets to Harris County Hospital District Foundation (Note 1)	–	–	–	–	–	(703)	–	(703)
	–	(417)	(149,812)	(150,229)	–	(1,181)	(146,978)	(148,159)
Balances at end of year	\$ 259,126	\$ 1,744	\$ –	\$ 260,870	\$ 253,541	\$ 1,802	\$ 89,542	\$ 344,885

See accompanying notes.

Harris County Hospital District and Affiliate, a
Component Unit of Harris County, Texas

Combined Statements of Cash Flows

	Year ended	
	February 29, 2000	February 28, 1999
	<i>(In Thousands)</i>	
Reconciliation of operating income to net cash used in operating activities:		
Operating income	\$ 5,585	\$ 70,061
Adjustments to reconcile operating income to net cash used in operating activities:		
Net cash provided by noncapital financing activities	(203,990)	(159,026)
Interest expense on revenue bonds	2,187	2,070
Depreciation and amortization expense	21,660	22,914
Provision for bad debt expense	144,347	218,620
Provision for uncollectible ad valorem taxes	7,682	-
Disproportionate Share III funds (recognized) deferred as revenue in the current year	(86,239)	(65,993)
Net decrease/(increase) in the fair value of investments	2,774	(636)
Changes in assets and liabilities:		
Increase in accounts receivable	(147,585)	(212,637)
Decrease/(increase) in ad valorem taxes receivable	(1,923)	28
Decrease/(increase) in inventories	(5)	489
Decrease/(increase) in prepaid expenses and other assets	(3,244)	1,159
Increase in accounts payable and accrued liabilities	4,730	8,396
Increase in bond interest payable	177	2,421
Increase in employee compensation and related benefit liabilities	1,684	1,292
Increase in vacation and sick leave benefits	764	373
Decrease in estimated third-party payor settlements	(3,891)	(2,527)
	(260,872)	(183,057)
Net cash used in operating activities	(255,287)	(112,996)
Noncapital financing activities		
Ad valorem taxes received	203,714	159,303
Operating grants received	4,132	3,409
Operating grant expenditures	(3,856)	(3,686)
Net cash provided by noncapital financing activities	203,990	159,026
Capital and related financing activities		
Acquisitions and construction of capital assets	(25,498)	(11,913)
Repayment of long-term debt	(14,200)	(12,800)
Net cash used in capital and related financing activities	(39,698)	(24,713)
Investing activities		
Purchase of investment securities	(121,749)	(150,142)
Proceeds from sale and maturities of investment securities	141,124	92,818
Decrease in assets limited as to use, net of change in fair value of investments	45,486	68,095
Net cash provided by investing activities	64,861	10,771
Net increase in cash and cash equivalents	(26,134)	32,088
Cash and cash equivalents at beginning of year	64,374	32,286
Cash and cash equivalents at end of year	\$ 38,240	\$ 64,374

See accompanying notes.

Harris County Hospital District and Affiliate, a
Component Unit of Harris County, Texas

Notes to Combined Financial Statements

February 29, 2000

1. Organization and Mission

Harris County Hospital District (the “District”), a discretely presented component unit of Harris County, Texas, was created by authorization of the legislature of the State of Texas and subsequent approval by the voters of Harris County, Texas, in November 1965. The District provides patient care to the indigent population of Harris County and receives a pro rata portion of property taxes levied by Harris County. The District operates two acute care hospitals, a hospital-based skilled nursing facility, rehabilitation and psychiatric unit, with a total of 906 operating beds and 12 health clinics. The District is exempt from federal income taxes.

Harris County Hospital District is presented as a discrete component unit of Harris County, Texas (legally separate from Harris County, Texas), as the members of the District’s governing board are appointed by Commissioners’ Court. The Commissioners’ Court approves the District’s tax rate and annual budget. Harris County, Texas, neither provides any funding to the District, holds title to any of the District’s assets, nor has any rights to any surpluses of the District.

The District’s primary mission is to provide quality preventive, medical, hospital, and emergency care to the indigent and needy sick of Harris County and to other county residents with the ability to pay. All activities conducted by the District are directly associated with the furtherance of this mission and are, therefore, considered to be operating activities.

The Harris County Hospital Foundation (the “Foundation”), organized under Section 501c (3) of the Internal Revenue Code, exists to generate resources to enhance the District’s mission in the community by providing support for programs outside the scope of services of the District. On June 24, 1998, the by-laws of the Foundation were amended whereby the Foundation became a non-member organization, and its trustees are primarily composed of individuals unaffiliated with the District. Therefore, effective March 1, 1998, the Foundation’s financial statements are not combined with the District.

Harris County Hospital District and Affiliate, a
Component Unit of Harris County, Texas

Notes to Combined Financial Statements (continued)

1. Organization and Mission (continued)

Community Health Choice, Inc. (the “HMO”), is a Texas not-for-profit corporation incorporated on May 8, 1996 and organized under Section 501c (4) of the Internal Revenue Code to operate as a health maintenance organization. The HMO was licensed by the Texas Department of Insurance on February 14, 1997. As of February 29, 2000, the HMO had approximately 20,000 enrollees. As of December 31, 1999, the capitalization of the HMO had fallen below the minimum statutory level set by the Department of Insurance.

2. Summary of Significant Accounting Policies

Charity Care Policy

The District accepts all patients regardless of their ability to pay. A patient is classified as a charity patient by reference to certain established eligibility policies of the District. These policies define charity services as those services for which no payment is anticipated. In assessing a patient’s inability to pay, the District utilizes the poverty income guidelines published by the State Community Services Administration and considers the size of the patient’s family unit.

Net Patient Service Revenues

Net patient service revenues are reported as the estimated net realized amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

Cash, Cash Equivalents, and Short-Term Investments

The District defines cash and cash equivalents as cash and investments that are highly liquid with less than three-month maturities when purchased. Short-term investments are investments with maturities in excess of three months when purchased.

Harris County Hospital District and Affiliate, a
Component Unit of Harris County, Texas

Notes to Combined Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

The District's demand and time deposits and short-term government securities at February 29, 2000 were insured by the Federal Deposit Insurance Corporation and collateralized by pledged U.S. government securities held by Bank of America in the District's name. Such total collateralization and insurance coverage is required by the Board of Managers of the District.

The District's cash, cash equivalents, and short-term investments are invested in fully collateralized time deposits, certificates of deposit, and government securities as authorized by Chapter 281 of the *Texas Health and Safety Codes* and Chapter 116 of *Texas Local Government Code*.

Ad Valorem Taxes

Ad valorem tax revenues are recorded at the time the taxes are assessed, net of provisions for uncollectible amounts, collection expenses, and appraisal fees. Subsequent adjustments to the tax rolls, made by the County Assessor, are included in revenues in the period such adjustments are made by the County Assessor.

Tobacco Settlement Revenue

Tobacco settlement revenues are the result of a settlement between various counties and Hospital Districts in Texas and the tobacco industry for tobacco related healthcare cost. The District recorded \$45,772,000 net of legal expenses in fiscal year 1999. Net settlement revenues for fiscal year 2001 and beyond are estimated to be between \$20 million and \$24 million annually. However, continued funding is not guaranteed.

Premiums and Revenue Recognition

Prepaid health care premiums from enrolled groups are reported as revenue in the month in which enrollees are entitled to receive health care.

Medical Claims Expense

The HMO arranges for comprehensive health care services to its members through capitation, a fixed, monthly payment made without regard to the frequency, extent, or nature of the health care services actually furnished, and through fee-for-service

Harris County Hospital District and Affiliate, a
Component Unit of Harris County, Texas

Notes to Combined Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

arrangements. Benefits are provided to enrolled members generally through the HMO's contractual relationships with physician groups and hospitals. The HMO's contracted providers may, in turn, contract with specialists or referral providers for specific services and are responsible for any related payments to those referral providers.

Inventories

Inventories are valued at the lower of cost or market and consist principally of supplies for general services and pharmaceuticals.

Property, Plant, and Equipment

Property, plant, and equipment are carried at cost or fair market value at the time of donation and include expenditures for new facilities and equipment and expenditures which substantially increase the useful life of existing property, plant, and equipment. Ordinary maintenance and repairs are charged to expense when incurred.

Depreciation of plant facilities and equipment is provided using the straight-line method over the estimated useful lives of the assets.

Deferred Bond Issue Costs

The costs associated with the issuance of the 1990 revenue bonds are being amortized over the term of the bond issue using the bonds-outstanding method.

Vacation Benefits

The cost of employees' vacation pay is recorded at the time vacation benefits are earned.

Specific-Purpose Funds

Specific-purpose funds are used to differentiate resources, the use of which is restricted by donors or grantors, from resources of general funds on which donors or grantors place no restriction or that arise as a result of the operations of the District for its stated purposes. Restricted gifts and other restricted resources are recorded as additions to the appropriate restricted fund.

Harris County Hospital District and Affiliate, a
Component Unit of Harris County, Texas

Notes to Combined Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Resources restricted by donors or grantors for specific operating purposes are reported in other revenue to the extent used within the period.

Use of Estimates

The preparation of financial statements in conformity with Generally Accepted Accounting Principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expense during the reported period. Actual results could differ from those estimates.

Reclassification

Certain 1999 amounts have been reclassified to conform with the current year presentation.

Principles of Combination

The combined financial statements include the accounts of the District and the HMO, as described above in Note 1. Management of the District believes the combined financial statements presented on a comparative basis to be the most reflective of the District's activities. Significant interentity accounts and transactions not eliminated in combination include medical premiums paid by the District to the HMO in the amounts of \$23,230,000 and \$20,548,000 for the years ended February 29, 2000 and February 28, 1999, respectively. These amounts are included as premium revenues and salary and employee benefits in the combined statements.

Other GAAP Policies

The District's accounting policy is to apply all Financial Accounting Standards Board ("FASB") Statements and Interpretations except for those which would conflict with or contradict Governmental Accounting Standards Board ("GASB") pronouncements.

Harris County Hospital District and Affiliate, a
Component Unit of Harris County, Texas

Notes to Combined Financial Statements (continued)

3. Net Patient Service Revenues

Net patient service revenues are composed of the following:

	Year ended	
	February 29 2000	February 28 1999
	<i>(In Thousands)</i>	
Gross patient service revenues, net of charity care provided	\$ 378,777	\$ 411,658
Deduction from revenues:		
Contractual allowance:		
Medicare	16,929	9,147
Medicaid	48,883	32,973
Managed Medicaid	9,619	7,712
Other discounts	11,869	8,444
Net patient service revenues	\$ 291,477	\$ 353,382

Charity care provided during the years ended February 29, 2000 and February 28, 1999, measured at established rates, totaled \$303,977,000 and \$257,478,000, respectively. These charges are not included in gross or net patient service revenues.

The District has agreements with third-party payors that provide for payments to the District at amounts different from its established rates. The amounts by which the established billing rates exceed the amounts recoverable from these programs are written off and accounted for as contractual allowances. A summary of the payment arrangements with major third-party payors follows.

Medicare

Inpatient acute care services and defined capital cost related to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Certain outpatient services related to Medicare beneficiaries are paid based on a cost reimbursement methodology. The District is reimbursed under this methodology using an estimated rate, with final settlement determined after submission of annual reports by the District and audits thereof by the Medicare fiscal intermediary. The District's Medicare cost reports have been audited by the Medicare fiscal intermediary through February 29, 1996.

Harris County Hospital District and Affiliate, a
Component Unit of Harris County, Texas

Notes to Combined Financial Statements (continued)

3. Net Patient Service Revenues (continued)

Medicaid

Inpatient services rendered to Medicaid program beneficiaries are also paid at prospectively determined rates per discharge similar to those of the Medicare inpatient program. Medicaid outpatient beneficiaries are reimbursed under a cost reimbursement methodology. For outpatients, the District is reimbursed a preliminary rate, with final settlement determined after submission of annual cost reports by the District and audits thereof by the Medicaid fiscal intermediary. The District's Medicaid cost reports have been audited by the Medicaid fiscal intermediary through March 31, 1993.

Cash received from the Medicare program accounted for approximately 24% and 28% of the District's total cash collections for patient service revenues for the years ended February 29, 2000 and February 28, 1999, respectively. Cash received from the Medicaid program (including managed Medicaid) accounted for approximately 53% and 49% of the District's total cash collections for patient service revenues for the years ended February 29, 2000 and February 28, 1999, respectively. Law and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. The District believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. While no such regulatory inquiries have been made, compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs.

4. Disproportionate Share III Program

The Disproportionate Share III Program was created in fiscal year 1992 by the State of Texas to create additional federal matching funds. These funds were distributed to selected hospitals that provide services to low-income and uninsured patients. As of February 29, 2000, the District had received \$544,207,000. According to the guidelines for the use of the Disproportionate Share III funds, the District may use the funds for the benefit of the indigent in either the immediate period or future periods.

Harris County Hospital District and Affiliate, a
Component Unit of Harris County, Texas

Notes to Combined Financial Statements (continued)

4. Disproportionate Share III Program (continued)

Effective March 1, 1997, the District, through a Board of Managers' resolution, changed its method of accounting for revenue recognition of Disproportionate Share III Program funds. The new method of accounting requires that all funds received by the District subsequent to February 28, 1997 be recognized as revenue upon their receipt. Prior to March 1, 1997, the District's method of accounting related to the revenue recognition of Disproportionate Share III Program funds required that the District recognize as revenue all funds as they were spent in accordance with the District's plan. The new method of accounting resulted in the District recognizing as revenue \$86,239,000 and \$65,993,000 of prior unexpended funds during the years ended February 29, 2000 and February 28, 1999, respectively, in order to fund a portion of the District's cost of providing indigent care. As of February 29, 2000, all prior unexpended funds have been recognized as revenue.

5. Long-Term Debt

Revenue Bonds

On September 15, 1990, the District refinanced the Series A 1986 Revenue Bonds through the issuance of Harris County Hospital District Refunding Revenue Bonds, Series 1990, in the principal amount of \$224,752,000, maturing annually through February 15, 2010. The Series 1990 Bonds bear interest at an effective rate of approximately 7.2% (stated rates ranging from 6.6% to 7.75%) and are payable in annual installments which began February 15, 1993. In addition to defeasing the Series A 1986 Revenue Bonds, proceeds of the Series 1990 Bonds were used to create a capital improvements fund for future expansion and a debt service reserve fund and to pay the costs of issuance. At February 29, 2000, the fair market value of the Series 1990 Bonds based on quoted market prices is approximately \$150,166,000.

The bonds are secured by a lien on the pledged revenues of the District and certain funds established pursuant to the Bond Order.

Principal amounts due in 2001, 2002, 2003, 2004, and 2005 are \$13,351,200, \$13,430,040, \$11,588,200, \$14,464,560, and \$17,679,320, respectively.

Harris County Hospital District and Affiliate, a
Component Unit of Harris County, Texas

Notes to Combined Financial Statements (continued)

6. Assets Limited as to Use

Assets limited as to use represent those assets whose use has been legally restricted related to the Series 1990 Bonds issue (fifty percent of the greatest debt service requirement scheduled to occur), funds restricted by donors, funds restricted by the Board for future debt service, or funds restricted by the State of Texas for future services to low-income and uninsured patients (see Note 4). Investments in government securities are recorded at fair value beginning March 1, 1998, whereas in all prior years, they were recorded at cost. The new method of recording investments in government securities at fair value was adopted to recognize GASB 31 and has been applied retroactively to investments in government securities of prior years. The adjustment of \$9,739,000 to retroactively apply the new method is included in the Statement of Changes in Fund Balance as a cumulative effect of change in accounting principle. GASB 31 does not effect the value of the District's investments in corporate discount notes and commercial paper since the maturity dates of these types of investments are less than one year at the time of purchase. The carrying amount of cash, time deposits, corporate discount notes, and commercial paper approximates fair value. The fair value of governmental securities is based on quoted market prices as of February 29, 2000 and February 28, 1999. The change in the fair value of governmental securities was a decrease of \$6,063,000 (of which \$2,774,000 was recorded in the unrestricted fund and \$3,289,000 was recorded in the Future Indigent Care and Specific Purpose Funds) for the year ended February 29, 2000 and an increase of \$636,000 for the year ended February 28, 1999. The following table sets forth the components of assets limited as to use at fair value at February 29, 2000:

Description of Assets	Total	Debt Service	Other
	<i>(In Thousands)</i>		
Cash and time deposits	\$ 265	\$ 204	\$ 61
Corporate discount notes and commercial paper	611	512	99
Government securities	<u>87,406</u>	<u>85,822</u>	<u>1,584</u>
	88,282	86,538	1,744
Less funds required for current liabilities	<u>16,422</u>	<u>16,422</u>	-
	<u>\$ 71,860</u>	<u>\$ 70,116</u>	<u>\$ 1,744</u>

Harris County Hospital District and Affiliate, a
Component Unit of Harris County, Texas

Notes to Combined Financial Statements (continued)

6. Assets Limited as to Use (continued)

The following table sets forth the components of assets limited as to use at fair value at February 28, 1999:

Description of Assets	Total	Debt Service	Future Indigent Care	Other
	<i>(In Thousands)</i>			
Cash and time deposits	\$ 761	\$ 147	\$ 373	\$ 241
Corporate discount notes and commercial paper	27,348	2,253	24,894	201
Government securities	112,021	46,386	64,275	1,360
	140,130	48,786	89,542	1,802
Less funds required for current liabilities	14,445	14,445	-	-
	<u>\$ 125,685</u>	<u>\$ 34,341</u>	<u>\$ 89,542</u>	<u>\$ 1,802</u>

7. Pension Plan

Description

The District has a noncontributory, defined benefit pension plan covering substantially all of its employees. It is a single-employer, self-administered, trustee plan in which a separate stand-alone financial report is issued. The plan is administered by a pension committee comprised of several District employees, including the District's Chief Financial Officer. As a unit of local government, the District's plan is not covered by the Employee Retirement Income Security Act of 1974 ("ERISA"). The plan is funded through contributions by the District which are actuarially determined. The projected unit credit method is used to determine both the funding and the pension benefit obligation.

Each participant shall have a monthly benefit payable for life equal to the greater of (1) the number of years of service multiplied by 1.50% of average monthly compensation (average base compensation received in five highest consecutive calendar years out of the ten complete calendar years prior to retirement) or (2) the accrued monthly retirement benefit determined as of January 1, 1989, plus the number of years of future service earned after January 1, 1989, multiplied by 1.50% of average monthly compensation,

Harris County Hospital District and Affiliate, a
Component Unit of Harris County, Texas

Notes to Combined Financial Statements (continued)

7. Pension Plan (continued)

subject to a minimum equal to the benefit earned under the plan prior to the adoption of the 6th Amendment as of September 30, 1991 (applies to non-highly-compensated employees only). Monthly benefit payments are subject to a minimum based on the number of years of service multiplied by \$6 and a maximum provision permitted to be paid under Section 415 of the Internal Revenue Code. Participants may also elect to receive their benefits in other optional forms approved by the Retirement Committee.

At January 1, 1999, date of the most recent actuarial valuation, pension plan membership consisted of:

Inactive participants:

Retirees and beneficiaries currently receiving benefits	1,543
Terminated employees with deferred benefits	1,267
Total inactive participants	<u>2,810</u>

Active participants:

Fully vested	2,459
Nonvested	1,524
Total active participants	<u>3,983</u>
Total participants	<u><u>6,793</u></u>

The District's annual payroll for employees covered by the pension plan as of the valuation dates of January 1, 1999 and 1998 was approximately \$118,440,000 and \$113,491,000, respectively. Total District payroll for the same period was approximately \$158,776,000 and \$153,165,000, respectively.

Funding

The amount shown as the "pension benefit obligation" is a standard disclosure measure of the present value of pension benefits, adjusted for the effects of projected salary increases and step-rate benefits, estimated to be payable in the future as a result of employee service to date. The measure is intended to help users assess progress made in accumulating sufficient assets to pay benefits when due and make comparisons among employers.

Harris County Hospital District and Affiliate, a
Component Unit of Harris County, Texas

Notes to Combined Financial Statements (continued)

7. Pension Plan (continued)

Annual Pension Cost and Net Pension Obligation

As a result of the District's cumulative net overcontribution of the annual required contribution, the District's net pension obligation is an asset. For fiscal year 2000, the District's annual pension cost was \$11,316,504, and the net pension asset was \$7,880,675, calculated as follows:

	2000
Annual required contribution	\$11,100,300
Interest on net pension asset	(647,750)
Adjustment to the annual required contribution	863,954
Annual pension cost	11,316,504
Contributions made	11,100,300
Decrease in net pension asset	216,204
Net pension asset beginning of year	(8,096,879)
Net pension asset end of year	<u><u>\$ (7,880,675)</u></u>

Fiscal Year Ending	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Asset
02/29/00	\$11,316,504	98.09%	\$ (7,880,675)
02/28/99	11,765,366	98.11%	(8,096,879)
02/28/98	\$12,049,834	98.11%	\$ (8,319,014)

The plan is on a calendar year-end and the actuarially determined contribution requirement intended to cover normal cost was approximately \$11,100,000 (9.4% of January 1, 1999 covered payroll) and \$11,543,000 (10.2% of January 1, 1998 covered payroll) for the years ended December 31, 1999 and 1998, respectively.

During the years ended February 29, 2000 and February 28, 1999, the District made cash contributions of \$11,100,300 and \$11,543,231, respectively, to the pension trust. Pension expense recognized in the combined statements of operations was \$11,100,300 and \$11,543,231 for the years ended February 29, 2000 and February 28, 1999, respectively.

Harris County Hospital District and Affiliate, a
Component Unit of Harris County, Texas

Notes to Combined Financial Statements (continued)

7. Pension Plan (continued)

Historical Information

		January 1			April 1	
	1999	1998	1997	1996	1995	1994
	<i>(In Thousands)</i>					
Net assets available for benefits	\$ 287,139	\$ 244,102	\$203,365	\$ 176,526	\$ 144,910	\$ 120,458
Pension benefit obligation	\$ 252,399	\$ 243,938	\$232,838	\$ 222,878	\$ 156,583	\$ 143,271
Net assets as a percentage of pension benefit obligation	113.8%	100.1%	87.3%	79.2%	92.5%	84.1%
Overfunded (unfunded) pension benefit obligation	\$ 34,740	\$ 164	\$ (29,473)	\$ (46,352)	\$ (11,673)	\$ (22,813)
Annual covered payroll	\$ 118,440	\$ 113,491	\$105,129	\$ 101,007	\$ 119,806	\$ 110,450
Overfunded (unfunded) pension benefit obligation as a percentage of annual covered payroll	29.3%	0.1%	(28.0)%	(45.9)%	(9.7)%	(20.7)%
Employer contribution as a percentage of covered payroll	9.7%	10.4%	10.9%	11.4%	6.2%	5.8%

8. Postretirement Benefits Other Than Pension

In addition to providing pension benefits, the District provides certain health care benefits for retired employees. The District's employees may become eligible for those benefits upon completing ten years of service. The cost of retiree health care insurance is recognized on a monthly accrual basis based on the amount of claims being paid. For the years ended February 29, 2000 and February 28, 1999, those costs were approximately \$3,008,000 and \$3,380,000, respectively. The number of participants eligible to receive the benefits was 5,054 at February 29, 2000.

Harris County Hospital District and Affiliate, a
Component Unit of Harris County, Texas

Notes to Combined Financial Statements (continued)

9. Defined Contribution Plan

The District has a defined contribution 401(k) plan (which qualifies as a tax-exempt employee benefit plan under Section 401(a) of the Internal Revenue Code) open to full-time, salaried employees who have completed one year of service or, effective October 1, 1998, ninety days of service. It is a single-employer, self-administered, trustee plan to which contributions are made by employees only on a biweekly basis not to exceed the statutory maximum of \$10,500 and \$10,000 during calendar years 2000 and 1999, respectively. The plan is a governmental plan and, as such, is specifically exempt from the reporting and disclosure requirements of Title I of ERISA.

The District administers the Harris County Hospital District Pension Plan and the Harris County Hospital District 401(k) Plan. The District issues publicly available financial reports that include financial statements and required supplementary information. The financial reports may be obtained by writing to Harris County Hospital District, Human Resources Department, 2525 Holly Hall, Houston, Texas 77054.

10. Deferred Compensation

The District has a deferred compensation plan for the benefit of its eligible employees under Section 457 of the Internal Revenue Code of 1954. The assets in the plan, which are not recorded on the accompanying combined balance sheets, remain the District's property until paid or made available to participants. The plan assets at February 29, 2000 and February 28, 1999 were approximately \$16,178,000 and \$13,914,000, respectively. A corresponding liability to the participants of an equal amount exists at February 29, 2000 and February 28, 1999.

Harris County Hospital District and Affiliate, a
Component Unit of Harris County, Texas

Notes to Combined Financial Statements (continued)

11. Concentrations of Credit Risk

The District provides services to its patients, most of whom are local residents and are insured under third-party payor agreements, in accordance with its charity care policy (Note 2). The mix of net receivables from patients and third-party payors at February 29, 2000 and February 28, 1999 is as follows:

	2000	1999
Medicaid	40%	44%
Medicare	26	26
Commercial and self-pay patients	34	30
	100%	100%

12. Commitments and Contingencies

The District is covered under the Texas Tort Claims Act (the “Act”). Under the Act, any claims and recoveries from pending or possible litigation due to personal injuries are limited to \$100,000 per person and \$300,000 per single occurrence of bodily injury or death. Professional liability claims have been asserted by various claimants. The claims are in various stages of processing and some may ultimately be brought to trial. There are also known and unknown incidents that have occurred through February 29, 2000 that may result in the assertion of additional claims. In the opinion of the District’s management, the outcomes of these actions will not have a material adverse effect on the financial position of the District.

At February 29, 2000, the District had commitments outstanding in the amount of approximately \$4,300,000 related to improvements at existing facilities.

Required Supplementary Information

Harris County Hospital District and Affiliate, a
Component Unit of Harris County, Texas

Schedule of Funding Progress for
Pension Plan

January 1, 1999

Valuation Date (1)	Actuarial Value of Assets (AVA) ¹ (2)	Actuarial Accrued Liability (AAL) (3)	Unfunded (Overfunded) Actuarial Accrued Liability (UAAL) (3) – (2) (4)	Funded Ratio (2)/(3) (5)	Annual Covered Payroll (6)	UAAL as % of Payroll (4)/(6) (7)
April 1, 1994	\$ 125,934	\$ 143,271	\$ 17,337	87.9%	\$ 110,450	15.7%
April 1, 1995	\$ 148,212	\$ 156,583	\$ 8,371	94.7%	\$ 119,806	7.0%
January 1, 1996 ²	\$ 164,464	\$ 165,588	\$ 1,124	99.3%	\$ 121,147	0.9%
January 1, 1996 ³	\$ 164,464	\$ 222,878	\$ 58,414	73.8%	\$ 101,007	57.8%
January 1, 1997	\$ 183,244	\$ 232,838	\$ 49,594	78.7%	\$ 105,129	47.2%
January 1, 1998 ⁴	\$ 204,821	\$ 243,938	\$ 39,117	84.0%	\$ 113,491	34.5%
January 1, 1999	\$ 236,570	\$ 252,399	\$ 15,829	93.7%	\$ 118,440	13.4%

Note 1: Dollar amounts in thousands.

Note 2: All required supplementary information has been prepared in accordance with Governmental Accounting Board Statement No. 25 and 27 (“GASB No. 25 and 27”), Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contributions Plans. GASB No. 25 and 27 were adopted by the District during the fiscal year ended February 28, 1998 and 1999, respectively.

¹Market value (1989 – 1993) based on Generally Accepted Accounting Principles’ recognition of investment gains and losses; adjusted market value (1994 and later) based on actuarial derivation of market value which recognizes gains and losses incurred over a five-year period (see “asset valuation method” on page 25).

²Before recognizing cost of Early Retirement Window Program.

³After recognizing cost of Early Retirement Window Program.

⁴After recognizing the ad-hoc cost-of-living increase for retirees effective January 1, 1998 approved by the Board of Managers at the December 4, 1997 meeting. This improvement increased actuarial accrued liability by \$3.446 million.

Harris County Hospital District and Affiliate, a
Component Unit of Harris County, Texas

Schedule of Employer Contributions
for Pension Plan

January 1, 1999

<u>Plan Year Ended</u>	<u>Annual Required Contribution</u>	<u>Percentage Contributed</u>
December 31, 1994	\$ 8,747,616	210%
December 31, 1995	\$ 8,154,507	111%
December 31, 1996	\$11,561,735	100%
December 31, 1997	\$11,821,605	100%
December 31, 1998	\$11,543,231	100%
December 31, 1999	\$11,100,300	100%
December 31, 2000	\$ 9,203,575	

Harris County Hospital District and Affiliate, a
Component Unit of Harris County, Texas

Schedule of Employer Contributions
for Pension Plan (continued)

The information presented in the required supplementary information was determined as part of the actuarial valuations at the dates indicated. Additional information as of the latest actuarial valuation follows:

Valuation date	January 1, 1999
Actuarial cost method	Project unit credit
Amortization method	Level dollar, open
Amortization period	18 years
Asset valuation method	Five-year smoothed market
Actuarial assumptions:	
Inflation	4.00%
Investment rate of return	8.00%
Projected salary increases (ultimate rate)	4.00%
Cost-of-living adjustments	Not applicable
Assumed retirement age	The earliest of a) attainment of age 65, b) attainment of age 63 and completion of ten years of service, or c) attainment of age 55 and completion of 30 years of service. Reference Note 1 regarding Early Retirement Window Program eligibility.
Mortality rates	The 1983 Group Annuity Male and Female Mortality Tables.

Other Reports

Harris County Hospital District and Affiliate, a
Component Unit of Harris County, Texas

Schedule of Expenditures of State Awards

State Grantor Program Title	State Award Numbers	Project Period	Expenditures
Texas Department of Health			
Diabetes Awareness & Education – Asian	99-03	09/01/98 – 08/31/99	\$ 87,627
	00-03	09/01/99 – 08/31/00	<u>13,454</u>
			101,081
Bureau of Children’s Health			
Case Management	99-01	09/01/98 – 08/31/99	68,857
Children with Special Health Care Needs	00-01	09/01/99 – 08/31/00	<u>61,534</u>
			130,391
Tuberculosis Elimination			
	99-01	09/01/98 – 08/31/99	3,220
	00-01	09/01/99 – 08/31/00	<u>35,000</u>
			38,220
<i>Passed through the University of Texas at Austin</i>			
African-American Breast Cancer Screening Outreach			
	UTA99-0132	11/01/98 – 08/31/99	21,476
	Not Available	09/01/99 – 08/31/00	<u>22,009</u>
			43,485
<i>Passed through Baylor College of Medicine</i>			
Texas Diabetes Prevention & Control	Not Available	10/31/99 – 9/30/00	16,631
Total State Financial Assistance			<u><u>\$ 329,808</u></u>

Note: This schedule is prepared using the accrual basis of accounting.

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

Board of Managers
Harris County Hospital District

We have audited the consolidated financial statements of Harris County Hospital District and Affiliate, a Component Unit of Harris County, Texas (the “District”) as of and for the years ended February 29, 2000 and February 28, 1999, and have issued our report thereon dated May 26, 2000. We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

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

Internal Control Over Financial Reporting

In planning and performing our audit we considered the District’s internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

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

May 26, 2000

Ernst + Young LLP

Report of Independent Auditors on Compliance with Requirements
Applicable to Each Major Program and on Internal Control Over
Compliance in Accordance With the State of Texas Single Audit Circular

Board of Managers
Harris County Hospital District

Compliance

We have audited the compliance of the Harris County Hospital District and Affiliate, a Component Unit of Harris County, Texas (the "District") with the types of compliance requirements described in the State of Texas Single Audit Circular, that are applicable to each of its major state programs for the year ended February 29, 2000. The District's major state programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major state programs is the responsibility of the District's management. Our responsibility is to express an opinion on the District's compliance based on our audit.

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

In our opinion, the District complied, in all material respects, with the requirements referred to above that are applicable to each of its major state programs for the year ended February 29, 2000.

Internal Control Over Compliance

The management of the District is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to state programs. In planning and performing our audit, we consider the District's internal control over compliance with requirements that could have a direct and material effect on a major state program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with the State of Texas Single Audit Circular.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major state program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

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

September 20, 2000

Ernst + Young LLP

Harris County Hospital District and Affiliate, a
Component Unit of Harris County, Texas

Schedule of Findings and Questioned Costs

Years ended February 29, 2000 and February 28, 1999

Part I – Summary of Auditor’s Results

Financial Statement Section

Type of Auditor’s Report Issued:	Unqualified
Internal Control over Financial Reporting:	
Material Weakness(es) identified?	No
Reportable condition(s) identified not considered to be material weaknesses?	None noted
Noncompliance material to financial statements noted?	No

State Awards Section

Dollar threshold used to distinguish between Type A and Type B state programs:	\$300,000
Auditee qualified as low-risk auditee?	Yes
Type of auditor’s report on compliance for major programs:	Unqualified

Harris County Hospital District and Affiliate, a
Component Unit of Harris County, Texas

Schedule of Findings and Questioned Costs (continued)

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

State Awards Section (continued)

Internal Control over compliance:

Material weakness(es) identified?	No
Reportable condition(s) not considered to be material weaknesses?	None noted
Any audit findings disclosed that are required to be reported in accordance with State of Texas Single Audit Circular (section 510 (a))?	No

Identification of Major State Program

State Award Number	Name of Program
	Texas Department of Health:
99-03	Diabetes Awareness & Education – Asian
00-03	Diabetes Awareness & Education – Asian
99-01	Bureau of Children’s Health – Case Management
00-01	Bureau of Children’s Health – Children with Special Health Care Needs

Harris County Hospital District and Affiliate, a
Component Unit of Harris County, Texas

Schedule of Findings and Questioned Costs (continued)

Part II – Schedule of Financial Statement Findings

None

Part III – Schedule of State Award Findings and Questioned Costs Section

None