

Combined Financial Statements

**HARRIS COUNTY HOSPITAL DISTRICT AND AFFILIATE, A COMPONENT UNIT OF
HARRIS COUNTY, TEXAS, INCLUDING OTHER REPORTS RELATED TO OFFICE OF
MANAGEMENT AND BUDGET CIRCULAR A-133 AND STATE OF TEXAS SINGLE
AUDIT CIRCULAR**

Years ended February 28, 2001 and February 29, 2000

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

Combined Financial Statements

Years ended February 28, 2001 and February 29, 2000

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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 component unit of Harris County, Texas, as of February 28, 2001 and February 29, 2000, and the related combined statements of operations and changes in fund balances, and cash flows for the years then ended. These combined financial statements are the responsibility of the District’s management. Our responsibility is to express an opinion on these combined financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States 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 combined 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 28, 2001 and February 29, 2000, and the combined results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

In accordance with *Government Auditing Standards*, we have issued a report dated June 1, 2001, on our consideration for 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 Federal and State Awards is presented for purposes of additional analysis as required by the U.S. Office of Management and Budget Circular A-133 *Audits of States, Local Governments, and Non-Profit Organizations*, and 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 audits 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.

June 1, 2001

Ernst & Young LLP

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

Combined Balance Sheets

	February 28, 2001	February 29, 2000
	<i>(In Thousands)</i>	
Assets		
Current assets:		
Cash and cash equivalents	\$ 63,411	\$ 38,240
Short-term investments	133,322	121,747
Accounts receivable, net of allowance for uncollectible accounts of \$144,138 in 2001 and \$148,439 in 2000	45,309	40,343
Current portion of ad valorem taxes receivable, net of allowance for uncollectible taxes of \$3,122 in 2001 and \$2,067 in 2000	20,492	11,313
Inventories	4,449	2,863
Prepaid expenses and other current assets	4,247	8,264
Current portion of assets limited as to use <i>(Note 6)</i>	12,649	16,422
Total current assets	283,879	239,192
Assets limited as to use or restricted, net of current portion <i>(Note 6)</i> :		
Debt service	91,038	70,116
Other	852	1,744
	91,890	71,860
Property, plant, and equipment:		
Buildings and fixed equipment	247,647	236,675
Major movable equipment	149,284	137,429
Less accumulated depreciation	(237,898)	(222,550)
	159,033	151,554
Land and improvements	11,569	11,172
Construction in progress	1,283	4,751
	171,885	167,477
Other assets:		
Ad valorem taxes receivable, net of current portion and allowance for uncollectible taxes of \$47,841 in 2001 and \$45,999 in 2000	3,693	4,201
Net pension asset <i>(Note 7)</i>	2,904	-
Deferred bond issue costs, net of accumulated amortization of \$5,880 in 2001 and \$4,666 in 2000	4,002	1,941
	10,599	6,142
Total assets	\$ 558,253	\$ 484,671

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

Combined Balance Sheets (continued)

	February 28, 2001	February 29, 2000
	<i>(In Thousands)</i>	
Liabilities and fund balances		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 54,909	\$ 46,168
Interest payable	454	3,071
Employee compensation and related benefit liabilities	13,348	9,699
Compensated absences	13,967	9,734
Estimated third-party payor settlements	4,606	6,369
Notes payable (<i>Note 5</i>)	12,388	-
Current portion of long-term debt	5,195	13,351
Total current liabilities	104,867	88,392
Long-term debt:		
Series 1990 revenue bonds, net of discount of \$690 in 2001 and \$1,309 in 2000 (<i>Note 5</i>)	59,440	135,409
Series 2000 revenue bonds, including premium of \$3,267 and deferred loss on refunding of \$5,959	97,388	-
Fund balances:		
Unrestricted	295,707	259,126
Specific-purpose funds	851	1,744
Total fund balances	296,558	260,870
Commitments and contingencies (<i>Note 12</i>)		

Total liabilities and fund balances	\$ 558,253	\$ 484,671
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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 28, 2001	February 29, 2000
	<i>(In Thousands)</i>	
Net patient service revenues <i>(Note 3)</i>	\$ 316,158	\$ 291,477
Disproportionate Share III <i>(Note 4)</i>	47,465	146,509
Net ad valorem tax revenues	306,674	197,955
Net tobacco settlement revenue	8,348	–
Premium revenues	23,592	41,733
Other operating revenues	29,623	21,165
Total revenues	731,860	698,839
 Operating expenses:		
Salaries and employee benefits	261,782	247,245
Pharmaceuticals and supplies	99,735	97,337
Physician services	77,878	70,024
Medical claims expense	18,470	38,418
Other purchased services	57,385	61,974
Provision for bad debt expense	145,020	144,347
Depreciation and amortization	21,767	21,660
Interest	13,242	12,249
Total operating expenses	695,279	693,254
Operating income	\$ 36,581	\$ 5,585

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 28, 2001			Year ended February 29, 2000			
	Unrestricted Fund Balance	Specific- Purpose Fund Balance	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	\$ 259,126	\$ 1,744	\$ 260,870	\$ 253,541	\$ 1,802	\$ 89,542	\$ 344,885
Additions:							
Operating income	36,581	—	36,581	5,585	—	—	5,585
Gifts, grants, and bequests	—	74	74	—	259	—	259
Investment income	—	79	79	—	86	—	86
Increase in fair value of investments	—	—	—	—	14	—	14
Federal funds received to provide indigent care	—	—	—	—	—	60,270	60,270
	36,581	153	36,734	5,585	359	60,270	66,214
Deductions:							
Transfer to other operating revenue	—	(1,028)	(1,028)	—	(417)	—	(417)
Transfer to Disproportionate Share III revenue	—	—	—	—	—	(146,509)	(146,509)
Decrease in fair value of investments	—	(18)	(18)	—	—	(3,303)	(3,303)
	—	(1,046)	(1,046)	—	(417)	(149,812)	(150,229)
Balances at end of year	\$ 295,707	\$ 851	\$ 296,558	\$ 259,126	\$ 1,744	\$ —	\$ 260,870

See accompanying notes.

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

Combined Statements of Cash Flows

	Year ended	
	February 28, 2001	February 29, 2000
	<i>(In Thousands)</i>	
Reconciliation of operating income to net cash used in operating activities:		
Operating income	\$ 36,581	\$ 5,585
Adjustments to reconcile operating income to net cash used in operating activities:		
Net cash provided by noncapital financing activities	(301,696)	(203,990)
Interest expense on capital financing	11,715	12,248
Depreciation and amortization expense	21,767	21,660
Provision for bad debt expense	145,020	144,347
Provision for uncollectible ad valorem taxes	3,694	7,682
Disproportionate Share III funds (recognized) deferred as revenue in the current year	-	(86,239)
Net (increase) decrease in the fair value of investments	(5,987)	2,774
Changes in assets and liabilities:		
(Increase) in accounts receivable	(149,986)	(147,585)
(Increase) in ad valorem taxes receivable	(12,365)	(1,923)
(Increase) in inventories	(1,586)	(5)
Decrease/(increase) in prepaid expenses and other assets	4,017	(3,244)
(Increase) in net pension asset	(2,904)	-
(Increase) in deferred bond issue costs	(3,276)	-
Increase in accounts payable and accrued liabilities	8,741	4,730
Increase/(decrease) in interest payable	(2,617)	177
Increase in employee compensation and related benefit liabilities	3,649	1,684
Increase in compensated absences	4,233	764
(Decrease) in estimated third-party payor settlements	(1,763)	(3,891)
	(279,344)	(250,811)
Net cash used in operating activities	(242,763)	(245,226)
 Noncapital financing activities		
Net proceeds restricted for a specific purpose	153	60,629
Other specific purpose activity	(1,046)	(63,990)
Ad valorem taxes received	297,873	203,714
Proceeds from Tax and Revenue Anticipation Notes	66,500	-
Repayment of Tax and Revenue Anticipation Notes	(66,500)	-
Operating grants received	8,459	4,132
Operating grant expenditures	(4,636)	(3,856)
Net cash provided by noncapital financing activities	300,803	200,629

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

Combined Statements of Cash Flows (continued)

	Year ended	
	February 28, 2001	February 29, 2000
	<i>(In Thousands)</i>	
Capital and related financing activities		
Acquisitions and construction of capital assets	\$ (25,545)	\$ (25,425)
Proceeds from Commercial Paper	12,388	-
Proceeds from Series 2000 Bonds	103,874	-
Defeasance of Series 1990 Bonds	(85,198)	-
Interest expense on capital financing	(11,715)	(12,248)
Repayment of long-term debt	(4,825)	(12,014)
Net cash used in capital and related financing activities	(11,021)	(49,687)
Investing activities		
Purchase of investment securities	(135,388)	(122,347)
Proceeds from sale and maturities of investment securities	123,950	141,124
(Decrease) increase in assets limited as to use	(10,410)	49,373
Net cash (used in) provided by investing activities	(21,848)	68,150
Net increase in cash and cash equivalents	25,171	(26,134)
Cash and cash equivalents at beginning of year	38,240	64,374
Cash and cash equivalents at end of year	\$ 63,411	\$ 38,240

See accompanying notes.

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

Notes to Combined Financial Statements

February 28, 2001

1. Organization and Mission

Harris County Hospital District (the "District"), a 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 and 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 the Commissioners' Court. The Commissioners' Court approves the District's tax rate and annual budget. Harris County, Texas, does not provide any funding to the District, hold title to any of the District's assets, or have 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 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.

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 28, 2001, the HMO had approximately 8,200 enrollees.

2. Summary of Significant Accounting Policies

Basis of Accounting

The accompanying combined financial statements are prepared on the accrual basis of accounting.

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)

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 ability 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, and includes estimated retroactive revenue adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered, and such amounts are adjusted in future periods as adjustments become known.

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.

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*. Such total collateralization and insurance coverage is required by the Board of Managers of the District.

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)

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 health care cost. The District recognized \$8,348,000, net of current and prior year legal expenses associated with the settlement, in fiscal year 2001. Net settlement revenues for fiscal year 2002 and beyond are estimated to be between \$13 million and \$15 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 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.

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)

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 bonds are being amortized over the term of the respective bond issue, using the bonds-outstanding method.

Compensated Absences

Effective March 2001, the District converted its vacation and sick leave plan to a paid time-off plan. Under the previous plan, the cost of employees' vacation pay was recorded at the time vacation benefits were earned, and unused benefits were payable at the time of termination. The cost of holiday and sick pay was recorded at the time of use. Under the paid time-off plan, the cost of all compensated absences is accrued at the time the benefits are earned. At the option of the employee or at the time of termination, unused benefits are payable at 50%. The District recorded the effect of the plan transition as of February 28, 2001 at an estimated cost of \$3,900,000.

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.

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

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)

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States 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.

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 \$6,941,000 and \$23,230,000 for the years ended February 28, 2001 and February 29, 2000, respectively. These amounts are included as premium revenues and salary and employee benefits in the combined statements.

Reclassifications

Certain reclassifications have been made to prior year amounts to conform with the current year presentation.

Other GAAP Policies

The District's accounting policy is to apply all Financial Accounting Standards Board ("FASB") Statements and Interpretations issued after November 30, 1989, 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 28,	February 29,
	2001	2000
	<i>(In Thousands)</i>	
Gross patient service revenues, net of charity care provided	\$ 414,627	\$ 378,777
Deduction from revenues:		
Contractual allowance:		
Medicare	19,419	16,929
Medicaid	54,148	48,883
Managed Medicaid	15,980	9,619
Other discounts	8,922	11,869
Net patient service revenues	\$ 316,158	\$ 291,477

Charity care provided during the years ended February 28, 2001 and February 29, 2000, measured at established rates, totaled \$290,957,000 and \$303,977,000, respectively. These charges are not included in 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 costs 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. Effective

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)

August 1, 2000, the Health Care Financing Administration, as authorized by the Balanced Budget Act of 1997, changed the reimbursement of outpatient services to a Prospective Payment System. The District's Medicare cost reports have been audited by the Medicare fiscal intermediary through February 29, 1996.

Medicaid

Inpatient services rendered to Medicaid program beneficiaries are 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 25% and 24% of the District's total cash collections for patient service revenues for the years ended February 28, 2001 and February 29, 2000, respectively. Cash received from the Medicaid program (including managed Medicaid) accounted for approximately 52% and 53% of the District's total cash collections for patient service revenues for the years ended February 28, 2001 and February 29, 2000, 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.

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

Notes to Combined Financial Statements (continued)

4. Disproportionate Share III Program

The Disproportionate Share III Program (“DSH”) was created in fiscal year 1992 by the State of Texas to create additional federal matching funds. These funds are distributed to selected hospitals that provide services to low-income and uninsured patients. As of February 28, 2001, the District had received \$591,672,000. According to the DSH guidelines, the District may use the funds for the benefit of the indigent in either the immediate period or future periods.

Effective March 1, 1997, the District, through a Board of Managers’ resolution, recognized DSH funds as revenue upon receipt. Prior to March 1, 1997, the District recognized DSH funds as revenue when they were spent in accordance with the DSH guidelines. The new method of accounting resulted in the District recognizing as revenue \$86,239,000 of prior unexpended funds during the year ended February 29, 2000, 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 August 9, 2000, the District refinanced a portion of the Harris County Hospital District Refunding Revenue Bonds, Series 1990 (“1990 Bonds”) through the issuance of Harris County Hospital District Refunding Revenue Bonds, Series 2000 (“2000 Bonds”), in the principal amount of \$100,080,000, maturing annually through February 15, 2016. The 2000 Bonds bear interest at an effective rate of approximately 5.87% (stated rates ranging from 5.75% to 6.00%) and are payable in annual installments beginning February 15, 2011. The proceeds of the 2000 Bonds were used to defease approximately 54% of the 1990 Bonds and to pay the costs of issuance, including underwriters discount and premium for municipal bond insurance, and to increase the debt service reserve fund. The refunding increased debt maturities from 2010 through 2016 and increased debt service requirements by \$63,461,000. The refunding resulted in a loss of \$6,724,000 which has been recorded as a deferred amount and is being amortized to interest expense over the life of the old bond issue. The primary components of this loss were the write-offs of unamortized deferred financing costs and bond discounts and the difference

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

Notes to Combined Financial Statements (continued)

5. Long-Term Debt (continued)

between amounts funded for the defeasance and the principal due on the 2000 Bonds. The financial statements reflect long-term debt net of the deferred amount of \$5,959,000 at February 28, 2001. Proceeds from the 2000 Bonds were used to fund partial defeasance of the 1990 Bonds through the irrevocable deposit of sufficient funds with trustees to pay the principal and interest of such bonds through their maturity. Accordingly, these trusteed funds and the related defeased indebtedness are excluded from balance sheets at February 28, 2001. Principal amounts of total defeased indebtedness outstanding at February 28, 2001, are \$60,846,000. The fair market value of the 1990 and 2000 Bonds outstanding at February 28, 2001, based on quoted market prices, is approximately \$182,321,000 and \$150,166,000, respectively.

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 on the bonds are as follows:

2002	\$ 5,195
2003	5,590
2004	6,010
2005	6,485
2006	6,965
Thereafter	<u>135,160</u>
Total	<u>\$ 165,405</u>

Notes Payable

In January of 2000, the District entered into an Offering Memorandum for issuance of Commercial Paper Subordinate Lien Revenue Notes, Series A. The offering was authorized to a maximum outstanding of \$50,000,000 and is secured by a letter of credit from Landesbank Hessen-Thüringen Girozentrale, Helaba Bank. At February 28, 2001, notes outstanding were \$12,388,000.

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

Notes to Combined Financial Statements (continued)

5. Long-Term Debt (continued)

Tax and Revenue Anticipation Notes

In September 2000, the District entered into a Tax and Revenue Anticipation Agreement for issuance of Series 2000 Tax and Revenue Anticipation Notes (the "Notes"). The Notes were authorized to a maximum outstanding of \$86,000,000. Under this agreement the District accessed interim financing totaling \$66,500,000. The notes were repaid prior to February 28, 2001 from ad valorem tax receipts.

6. Assets Limited as to Use

Assets limited as to use represent those assets whose use has been legally restricted related to the 1990 and 2000 Bonds issues (fifty percent of the greatest debt service requirement scheduled to occur), funds restricted by donors or funds restricted by the Board for future debt service. 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. 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 28, 2001 and February 29, 2000. The change in the fair value of governmental securities was an increase of \$5,984,000 (of which \$5,988,000 was recorded in the unrestricted fund and \$(4,000) was recorded in the Specific Purpose

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)

Funds) for the year ended February 28, 2001 and a decrease of \$6,063,000 for the year ended February 29, 2000. The following table sets forth the components of assets limited as to use at fair value at February 28, 2001:

Description of Assets	Total	Debt Service	Other
	<i>(In Thousands)</i>		
Cash and time deposits	\$ 550	\$ 270	\$ 280
Government securities	103,989	96,417	7,572
	104,539	96,687	7,852
Less funds required for current liabilities	12,649	5,649	7,000
	\$ 91,890	\$ 91,038	\$ 852

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	87,406	85,822	1,584
	88,282	86,538	1,744
Less funds required for current liabilities	16,422	16,422	-
	\$ 71,860	\$ 70,116	\$ 1,744

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

Notes to Combined Financial Statements (continued)

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 actuarially-determined contributions by the District. 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, 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.

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

Notes to Combined Financial Statements (continued)

7. Pension Plan (continued)

At January 1, 2000, date of the most recent actuarial valuation, pension plan membership consisted of:

Inactive participants:	
Retirees and beneficiaries currently receiving benefits	1,555
Terminated employees with deferred benefits	1,375
Total inactive participants	<u>2,930</u>
Active participants:	
Fully vested	2,560
Nonvested	1,610
Total active participants	<u>4,170</u>
Total participants	<u><u>7,100</u></u>

The District's annual payroll for employees covered by the pension plan as of the valuation dates of January 1, 2000 and 1999 was approximately \$137,552,000 and \$118,440,000, respectively. Total District payroll for the same period was approximately \$178,593,000 and \$158,776,000, respectively.

Funding

The amount shown as the "net pension asset" in the combined balance sheets 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 2001, the District's annual pension cost was \$4,976,819, and the net pension asset was \$2,903,856, calculated as follows:

	<u>2001</u>
Annual required contribution	\$ 4,432,820
Interest on net pension asset	(630,454)
Adjustment to the annual required contribution	<u>1,174,453</u>
Annual pension cost	4,976,819
Contributions made	—
Decrease in net pension asset	<u>4,976,819</u>
Net pension asset beginning of year	<u>(7,880,675)</u>
Net pension asset end of year	<u><u>\$ (2,903,856)</u></u>

<u>Fiscal Year Ending</u>	<u>Annual Pension Cost (APC)</u>	<u>Percentage of APC Contributed</u>	<u>Net Pension Asset</u>
02/28/01	\$ 4,976,819	0.00%	\$ (2,903,856)
02/29/00	11,316,504	98.09%	(7,880,675)
02/28/99	11,765,366	98.11%	(8,096,879)

The plan is on a calendar year-end, and the actuarially-determined contribution requirement intended to cover normal cost was approximately \$4,433,000 (3.2% of January 1, 2000 covered payroll) and \$11,100,000 (9.4% of January 1, 1999 covered payroll) for the years ended December 31, 2000 and 1999, respectively. During the year ended December 31, 2000, the District modified certain methods, including asset smoothing, asset corridor, and amortization period, which are used in the actuarial assumptions to value the pension plan. These changes resulted in a decrease of approximately \$4,771,000 in the annual required contribution for the year.

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

Notes to Combined Financial Statements (continued)

7. Pension Plan (continued)

During the year ended February 29, 2000, the District made cash contributions of \$11,100,300 to the pension trust. There were no contributions made during the year ended February 28, 2001. Pension expense recognized in the combined statements of operations was \$(2,903,856) and \$11,100,300 for the years ended February 28, 2001 and February 29, 2000, respectively. The effect of the District's adoption of the accrual method of accounting for pension costs as required by GASB No. 27, *Accounting for Pensions by State and Local Governmental Employers*, has been reflected in the pension expense recognized for the year ended February 28, 2001.

Historical Information

	2000	January 1 1999	1998
	<i>(In Thousands)</i>		
Net assets available for benefits	\$ 314,821	\$ 287,139	\$ 244,102
Pension benefit obligation	\$ 260,580	\$ 244,672	\$ 243,938
Net assets as a percentage of pension benefit obligation	120.8%	117.4%	100.1%
Overfunded (unfunded) pension benefit obligation	\$ 54,241	\$ 42,467	\$ 164
Annual covered payroll	\$ 137,552	\$ 118,440	\$ 113,491
Overfunded (unfunded) pension benefit obligation as a percentage of annual covered payroll	39.4%	35.9%	0.1%
Employer contribution as a percentage of covered payroll	8.1%	9.7%	10.4%

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

Notes to Combined Financial Statements (continued)

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 premiums being paid. For the years ended February 28, 2001 and February 29, 2000, those costs were approximately \$3,653,000 and \$3,008,000, respectively. The number of retirees and beneficiaries eligible to receive the benefits was 1,555 at January 1, 2000.

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 during calendar years 2001 and 2000, 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 28, 2001 and February 29, 2000 were approximately \$14,692,000 and \$16,178,000, respectively. A corresponding liability to the participants of an equal amount exists at February 28, 2001 and February 29, 2000.

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 28, 2001 and February 29, 2000 is as follows:

	<u>2001</u>	<u>2000</u>
Medicaid	53%	40%
Medicare	18	26
Commercial and self-pay patients	29	34
	<u>100%</u>	<u>100%</u>

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 28, 2001 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 28, 2001, the District had commitments outstanding in the amount of approximately \$1,206,000 related to improvements at existing facilities.

The District had rental expenses related to its operating leases of approximately \$3,500,000 and \$3,900,000 during the years ended February 28, 2001 and February 29, 2000, respectively.

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, 2000

Valuation Date (1)	Actuarial Value of Assets (AVA) ¹ (2)	Actuarial Accrued Liability (AAL) (3)	Unfunded (Overfunded) Actuarial Accrued Liability (U(O)AAL) (3) – (2) (4)	Funded Ratio (2)/(3) (5)	Annual Covered Payroll (6)	U(O)AAL as % of Payroll (4)/(6) (7)
January 1, 1998 ²	\$ 204,821	\$ 243,938	\$ 39,117	84.0%	\$ 113,491	34.5%
January 1, 1999	\$ 257,338	\$ 244,672	\$ (12,666)	105.2%	\$ 118,440	(10.7)%
January 1, 2000	\$ 297,517	\$ 260,580	\$ (36,937)	114.2%	\$ 137,552	(26.9)%

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, 1999 and 2000, respectively.

¹Adjusted 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 28).

²After 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, 2000

<u>Plan Year Ended</u>	<u>Annual Required Contribution</u>	<u>Percentage Contributed</u>
December 31, 1998	\$11,543,231	100%
December 31, 1999	\$11,100,300	100%
December 31, 2000	\$ 4,432,820	0%
December 31, 2001	\$ 3,733,901	

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, 2000
Actuarial cost method	Projected unit credit
Amortization method	Level dollar, open
Amortization period	10 years
Asset valuation method	Three-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
Mortality rates	The 1983 Group Annuity Male and Female Mortality Tables.

Other Reports Related to Office of
Management and Budget Circular A-133
and State of Texas Single Audit Circular

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

Schedule of Expenditures of Federal and State Awards

Year ended February 28, 2001

<u>State Grantor or Federal Program Title</u>	<u>Catalog of Federal Domestic Assistance Number</u>	<u>Grantor Number</u>	<u>Grant Period</u>	<u>Expenditures</u>
U.S. Department of Housing and Urban Development				
<i>Passed through Harris County Housing and Community Development:</i>				
Supportive Housing Program III	14.235	TX-21-B96-0613	03-01-98 – 04-30-01	\$ 281,349
Community Housing and Management Program (CHAMP) (CDBG)	14.218	CD99-096	02-01-00 – 01-31-01	11,145
Community Housing and Management Program (CHAMP) (ESG)	14.231	CD99-096	04-01-00 – 01-31-01	53,100
<i>Passed through the City of Houston:</i>				
Emergency Shelter Grant	14.231	N/A	12/10/98 – 10/31/00	18,319
Robert Wood Johnson Homeless Families Program	14.218	50210	12/10/98 – 10/31/00	<u>25,651</u>
Total U.S. Department of Housing and Urban Development				\$ 389,564

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

Schedule of Expenditures of Federal and State Awards (continued)

<u>State Grantor or Federal Program Title</u>	<u>Catalog of Federal Domestic Assistance Number</u>	<u>Grantor Number</u>	<u>Grant Period</u>	<u>Expenditures</u>
U.S. Department of Health and Human Services				
Outpatient Early Intervention Services with Respect to HIV Disease	93.918	H76-HA00128-09	01-01-00 – 12-31-00	\$ 434,427
	93.918	H76-HA00128-10	01-01-01 – 12-31-01	87,424
Ryan White Title III Planning Grant	93.918	P06-HA00142-01	09-01-99 – 08-31-00	30,526
Healthcare for the Homeless	93.151	H66-CS00428-13	11-01-99 – 10-31-00	997,745
	93.151	H66-CS00428-14	11-01-00 – 10-31-01	417,775
<i>Passed through Harris County Public Health & Environmental Services:</i>				
Ryan White Outpatient Ambulatory (Fee for Service)	93.914	00GEN0131	03-01-00 – 02-28-01	3,762,369
Ryan White Women's Program (Fee for Service)	93.914	00GEN0132	03-01-00 – 02-28-01	309,322

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

Schedule of Expenditures of Federal and State Awards (continued)

<u>State Grantor or Federal Program Title</u>	<u>Catalog of Federal Domestic Assistance Number</u>	<u>Grantor Number</u>	<u>Grant Period</u>	<u>Expenditures</u>
<i>Passed through Houston Regional HIV/AIDS Resource Group:</i>				
Ryan White Title IV Women's Program	93.153	HCH.009	08-01-99 – 07-31-00	\$ 109,379
	93.153	HCH.010	08-01-00 – 07-31-01	139,223
<i>Passed through State Department of Health:</i>				
Breast & Cervical Cancer Control Program (Fee for Service)	93.919	7415369366-00-03	09-01-99 – 08-31-00	25,673
	93.919	7415369366-01-03	09-01-00 – 08-31-01	38,259
Put Prevention Into Practice	93.991	7415369366A99-02	09-01-99 – 08-31-00	39,023
	93.991	7415369366A00-02	09-01-00 – 08-31-01	27,416
Women and Children (Fee for Service)	93.994	7415369366-99-02	09-01-99 – 08-31-00	253,677
	93.994	7415369366-00-02	09-01-00 – 08-31-01	243,518

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

Schedule of Expenditures of Federal and State Awards (continued)

<u>State Grantor or Federal Program Title</u>	<u>Catalog of Federal Domestic Assistance Number</u>	<u>Grantor Number</u>	<u>Grant Period</u>	<u>Expenditures</u>
<i>Passed through Texas Commission on Alcohol and Drug Abuse, passed through the University of Texas Health Science Center:</i>				
Houston Drug Abuse Treatment Campus- Medical Services	93.911	N/A	09-01-99 – 08-31-00	\$ 9,806
Total U.S. Department of Health and Human Services				<u>\$ 6,925,562</u>
Total Federal Financial Assistance				\$ 7,315,126
Texas Department of Health				
Diabetes Awareness & Education-Asian		7415369366A00-03	09-01-99 – 08-31-00	72,114
		7415369366-01-03	09-01-00 – 08-31-01	25,650
Women and Children/Case Management		7415369366A99-01	09-01-99 – 08-31-00	93,107
		7415369366A00-01	09-01-00 – 08-31-01	88,724
Tuberculosis Elimination		7415369366-00-01	09-01-99 – 08-31-00	–
		7415369366-01-01	09-01-00 – 08-31-01	22,540

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

Schedule of Expenditures of Federal and State Awards (continued)

<u>State Grantor or Federal Program Title</u>	<u>Catalog of Federal Domestic Assistance Number</u>	<u>Grantor Number</u>	<u>Grant Period</u>	<u>Expenditures</u>
EMS/HOSP		7415369366B2001	10-01-00 – 08-31-01	\$ 1,800
<i>Passed through the University of Texas @ Austin:</i>				
African-American Breast Cancer Screening Outreach		UTA00-060	09-01-99 – 08-31-00	32,760
		UTA01-183	09-01-00 – 08-31-01	20,692
<i>Passed through Baylor College of Medicine</i>				
Texas Diabetes Prevention & Control Initiative		N/A	10-31-90 – 9-30-00	97,875
		N/A	10-01-00 – 08-31-01	56,665
Telecommunication Infrastructure Fund Board				
Public Health Technology Advancement- Collaborative		QE-2000-TTA1C-3577	04-01-00 – 06-30-01	<u>233,980</u>
Total State Assistance				<u>\$ 745,907</u>
Total Federal and State Financial Assistance				<u><u>\$ 8,061,033</u></u>

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

Notes to Schedule of Expenditures of Federal and State Awards

February 28, 2001

1. Significant Accounting Policies

Basis of Accounting

The schedule of expenditures of federal and state awards is prepared on the accrual basis of accounting.

2. Fee-for-Service Programs

Certain grants are noted as fee-for-service programs on the schedule of expenditures of federal and state awards. The expenditures shown for these grants actually represent amounts paid for particular services performed by the District during fiscal year 2001.

3. Subrecipients

Of the federal award expenditures presented in the schedule, the District provided federal awards to subrecipients as follows:

Program Title	CFDA No.	Amount Provided
Health Care for the Homeless	93.151	\$ 380,284
Outpatient Early Intervention Services With Respect to HIV Disease	93.918	87,251
Ryan White Outpatient Ambulatory Grant	93.914	990,224
Women and Children	93.994	180,059
Total		<u>\$1,637,818</u>

Report of Independent Auditors 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 combined financial statements of the Harris County Hospital District and Affiliate (the “District”) as of and for the year ended February 28, 2001, and have issued our report thereon dated June 1, 2001. We conducted our audit in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the District’s combined 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 combined 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 combined 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 combined 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 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.

June 1, 2001

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 *OMB Circular A-133*

Board of Managers
Harris County Hospital District and Affiliate

Compliance

We have audited the compliance of Harris County Hospital District and Affiliate (the "District") with the types of compliance requirements described in the U.S. Office of Management and Budget ("OMB") *Circular A-133 Compliance Supplement* that are applicable to each of its major federal and state programs for the year ended February 28, 2001. The District's major federal and state programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal and state programs is the responsibility of 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 auditing standards generally accepted in the United States; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform our 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 other such 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 federal and state programs for the year ended February 28, 2001.

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 federal programs. In planning and performing our audit, we considered the District's internal control over compliance with requirements that could have a direct and material effect on a major federal and state program in order to determine our auditing procedures for the purpose of expressing an opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

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 of the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major federal and 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 solely for the information and use of the Board of Managers, management, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

June 1, 2001

Ernst & Young LLP

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

Schedule of Findings and Questioned Costs – **Federal Programs**

Year ended February 28, 2001

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 considered to be material
weakness(es)? None noted

Noncompliance material to financial statements noted? No

Federal Awards Section

Dollar threshold used to determine Type A programs: \$300,000

Auditee qualified as low-risk auditee? Yes

Type of auditor’s report on compliance of major programs: Unqualified

Internal control over compliance:

Material weakness(es) identified? No

Reportable condition(s) identified considered to be material
weakness(es)? None noted

Any audit findings disclosed that are required to be reported in
accordance with Circular A-133 (Section .510(a))? No

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

Schedule of Findings and Questioned Costs – **Federal Programs (continued)**

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

Identification of major programs:

CFDA Number	Name of Federal Program or Cluster
93.918	U.S. Department of Health and Human Services: Outpatient Early Intervention Services with Respect to HIV Disease, Ryan White Title III Planning Grant.
93.914	U.S. Department of Health and Human Services: Passed through Harris County Public Health & Environmental Services, Ryan White Outpatient Ambulatory Grant, Ryan White HIV Medications Purchase Grant.
93.994	U.S. Department of Health and Human Services: Passed through Texas Department of Health, Women & Children Grant.
93.153	U.S. Department of Health and Human Services: Passed through Houston Regional HIV/AIDS Resource Group, Ryan White Title IV Women’s Program.

Part II – Schedule of Financial Statement Findings

None.

Part III – Schedule of Federal Award Findings and Questioned Costs

None.

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

Schedule of Findings and Questioned Costs – **State Programs**

Year ended February 28, 2001

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 considered to be material
weakness(es)? None noted

Noncompliance material to financial statements noted? No

State Awards Section

Dollar threshold used to determine Type A programs: \$300,000

Auditee qualified as low-risk auditee? Yes

Type of auditor’s report on compliance of major programs: Unqualified

Internal control over compliance:

Material weakness(es) identified? No

Reportable condition(s) identified considered to be material
weakness(es)? None noted

Any audit findings disclosed that are required to be reported in
accordance with Circular A-133 (Section .510(a))? No

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

Schedule of Findings and Questioned Costs – **State Programs (continued)**

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

Identification of major programs:

State Award Number	Name of State Program or Cluster
N/A`	Texas Department of Health: Passed through Baylor College of Medicine, Texas Diabetes Prevention and Control Initiative.
QE-2000 – TTA1C-3577	Telecommunications Infrastructure Fund Board: Public Health Technology Advancement Collaborative

Part II – Schedule of Financial Statement Findings

None.

Part III – Schedule of State Award Findings and Questioned Costs

None.

Report of Independent Auditors on Texas Commission on Alcohol and Drug Abuse Schedule of Revenues, Expenditures, and Changes in Fund Balance

Board of Managers
Harris County Hospital District

The audited schedule of expenditures of federal and state awards of the Harris County Hospital District and Affiliate (the "District") and our report thereon are presented in a preceding section of this report. The following information is presented for purposes of additional analysis of the schedule of expenditures of federal and state awards and is not a required part of the schedule of expenditures of federal and state awards of the District. The information has been subjected to the auditing procedures applied in our audit of the schedule of expenditures of federal and state awards and, in our opinion, is fairly stated in all material respects in relation to the schedule of expenditures of federal and state awards.

Ernst & Young LLP

June 1, 2001

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

Texas Commission on Alcohol and Drug Abuse Schedule of Revenues,
Expenditures, and Changes in Fund Balance

Grantor Agency: TEXAS COMMISSION ON ALCOHOL AND DRUG ABUSE
 Program Title: Houston Drug Abuse Treatment Campus – Medical Services
 Award Period: 09-01-99 to 08-31-00
 Audit Period: 03-01-00 to 02-28-01

Revenues

Federal funds passed through TCADA	\$ 9,806
Harris County Hospital District	–
Program Income	–
Total Revenue	9,806

Expenditures

Personnel	8,007
Fringe Benefits	1,303
Travel	–
Equipment	–
Supplies	96
Contractual	–
Other	400
Total Direct Costs	9,806
Indirect Costs	–
Total Expenditures	9,806
Excess Expenditures Over Revenues	–
Beginning Fund Balance, March 1, 2000	–
Ending Fund Deficit, February 28, 2001	\$ –