

COMBINED FINANCIAL STATEMENTS

Harris County Hospital District and Affiliate, a Component Unit of  
Harris County, Texas  
Years ended February 28, 2003 and 2002 with Report of Independent  
Auditors

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

Combined Financial Statements

Years ended February 28, 2003 and 2002

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## Management's Discussion and Analysis

This section of the Harris County Hospital District's ("District") financial report presents background information and our analysis of the District's financial results for the fiscal year March 1, 2002 through February 28, 2003. Please read this section in conjunction with the District's financial statements that begin on page 3.

### Financial Highlights

- The District's net assets increased \$75.9 million or 23% given the income reported for the year.
- During the year the District's net operating revenue increased by \$113 million while expenses increased \$82 million over the prior year. Patient service revenues increased at a greater rate than costs by \$31 million. Changes in the Disproportionate Share Program ("DSH") and the implementation of the Upper Payment Limit program ("UPL") provided the District with an additional \$49.6 million in funding for patient services for fiscal 2003.
- Taxes generated an additional \$16.8 million while the District experienced a reduction of \$2.5 million in net tobacco fund monies as compared to the prior year.
- During the year, the District made the following significant capital acquisitions and resource investments:
  - Clinical systems for District laboratories,
  - Patient business services and coordinated care systems software and implementation,
  - Replacement equipment for patient beds, bedside monitors and echomachine for pediatrics, ultrasound machines, ventilators, IV pumps, sterilization equipment, anesthesia machines, radiology diagnostics, and a cardiac monitoring system,
  - Pharmacy equipment and automated inventory and dispensing systems,
  - Scrub dispensing unit,
  - Renovations in Ben Taub pharmacy, LBJ angio suite, and both Ben Taub and LBJ emergency centers,
  - District parking expansions, and

- LBJ and Ben Taub CT scanners.

The source of funding for these projects was derived from operations.

### **Financial Statements**

The District's financial statements are prepared on the accrual basis of accounting and present the District's operational activities in a manner similar to that of private sector companies. The financial statements consist of three statements: (1) Statement of Net Assets, (2) Statement of Revenue, Expenses, and Changes in Net Assets, and (3) Statement of Cash Flows. The statements provide information about the combined activities of the District and Community Health Choice, Inc. (the "HMO"). The Statement of Net Assets and the Statement of Revenue, Expenses, and Changes in Net Assets reflect the District's financial position at the end of the year and report the District's net assets and changes in them as a result of the District's revenues and expenses for the year. The term "net assets" represents the difference between assets, or the District's investment in resources, and liabilities, or the District's obligation to its creditors. Increases or decreases in net assets are an indicator of whether financial health is improving or deteriorating. Other non-financial factors should be considered however in evaluating financial health, such as changes in the District's patient base, changes in economic conditions, taxable property values and tax rates and changes in government legislation. The Statement of Cash Flows reports cash receipts, cash payments, and net changes in cash resulting from operations, investing, and financing activities. The statement explains where cash came from, how it was used, and the change in cash balance during the year.

## Net Assets

A summary of the District's assets and liabilities is presented in Table I below:

**TABLE I**  
**Condensed Summary of Assets and Liabilities**  
**(In Millions)**

	<b>FY 2003</b>	<b>FY 2002</b>	<b>Dollar Change</b>	<b>Total % Change</b>
Current and other assets	\$ 495	\$ 423	\$ 72	17%
Capital assets	178	179	(1)	—
Total assets	<u>\$ 673</u>	<u>\$ 602</u>	<u>\$ 71</u>	<u>12%</u>
Long-term debt outstanding	\$ 149	\$ 152	\$ (3)	(2)%
Other liabilities	120	122	(2)	(2)
Total liabilities	<u>\$ 269</u>	<u>\$ 274</u>	<u>\$ (5)</u>	<u>(2)%</u>
Invested in capital assets, net of related debt	\$ 12	\$ 11	\$ 1	9%
Restricted	36	34	2	6
Unrestricted	356	283	73	26
Total net assets	<u>\$ 404</u>	<u>\$ 328</u>	<u>\$ 76</u>	<u>23%</u>

As can be seen in Table I, net assets increased \$76 million in fiscal year 2003. The change in net assets is primarily the result of increased operating revenues including the State of Texas' implementation of the Upper Payment Limit program. The District's revenues from the DSH and UPL programs were \$99 million this year compared to \$50 million last year. Additionally, net patient services revenues and premium revenues increased \$23 million and \$39 million, respectively, as compared to fiscal 2002.

## Summary of Revenues, Expenses, and Changes in Net Assets

The following table summarizes the District's revenue and expenses for each of the fiscal years ended February 28, 2003 and February 28, 2002, and the changes in net assets during each of those years.

**TABLE 2**  
**Condensed Statements of Revenues, Expenses, and Changes in Net Assets**  
**(In Thousands)**

	<b>2003</b>	<b>2002</b>
Operating revenue:		
Net patient service revenue	<b>\$ 220,317</b>	\$ 196,999
Disproportionate Share III and Upper Payment Limit	<b>99,245</b>	49,611
Premium revenues	<b>65,865</b>	26,738
Other operating revenues	<b>10,315</b>	9,635
Total operating revenues	<b>395,742</b>	282,983
Operating expenses:		
Salaries, wages, and benefits	<b>319,700</b>	286,565
Purchased services and supplies	<b>253,297</b>	240,200
Medical claims expenses	<b>57,385</b>	20,984
Depreciation and amortization	<b>25,433</b>	24,645
Interest expense	<b>10,482</b>	11,624
Total operating expenses	<b>666,297</b>	584,018
Operating loss	<b>(270,555)</b>	(301,035)
Nonoperating revenue	<b>346,390</b>	332,455
Restricted contributions	<b>48</b>	9
Change in net assets	<b>75,883</b>	31,429
Total net assets – beginning of year	<b>327,987</b>	296,558
Total net assets – end of year	<b>\$ 403,870</b>	\$ 327,987

The District's net patient service revenue increased \$23 million in 2003 as a result of continued improvements throughout the revenue cycle including rate increases, better identification of third party payers, improved charge capture, and billing and collections.

Revenues from the Disproportionate Share III and Upper Payment Limit programs increased \$49.6 million because of \$72.7 million in UPL revenues. This is the first year that the District has received funds from the program that began in July 2001. Due to the delay in implementing the program, \$32.2 million is for a period prior to fiscal year 2003. The District is unable to estimate the continuance or amount of future funding of the UPL program.

The District recognized premium revenue through its not-for-profit HMO subsidiary, Community Health Choice, Inc. Premium revenue increased \$39 million due to a 246% growth in membership.

Salaries and wages increased \$28.4 million or 12% due to merit increases and changes in the compensation plan to reflect market adjustments to enable the District to retain current staff and recruit additional needed staff. Related benefits increased \$4.7 million or 10% primarily in the areas of payroll taxes and employee medical benefits.

Overall, purchased services and supplies increased \$13 million or 5%. Physician service costs were \$7 million or 8% greater than in the prior year primarily due to expanded staffing costs. The District expended \$3 million over the prior year in its cost for other purchased services. These increased costs were reflected in non-clinical purchased services and consulting fees, collection fees, rental/lease expense, and more than \$1 million in increased insurance premiums in the aftermath of Tropical Storm Allison. The District did experience, however, \$2 million in savings on utilities. The cost of supplies increased 3% or \$2.9 million primarily in medical operating supplies.

Medical claims expense associated with the HMO increased by \$36.4 million due to a 246% growth in membership during the year.

Overall the District's operating loss decreased \$30 million or 10%. The District receives property tax revenues to subsidize the cost of services provided to qualified uninsured patients. Although the costs incurred to provide these services are reflected above as operating expenses, the property tax revenues are required to be reported as nonoperating revenues.

Nonoperating revenues consist of property tax revenue, investment income, and tobacco settlement monies. Tax revenues increased \$16.8 million or 5% as a result of increased property values. Investment income declined approximately 3% due to declining interest rates during the year. In fiscal 2003 the District received \$4.6 million in tobacco settlement revenues as compared to \$7.1 million in 2002, a decrease of \$2.5 million or 35%.

### **Capital Assets and Debt Financing**

During the past year the District has invested \$25 million in a wide range of assets including medical equipment replacement and modernization, information technology, and facility construction and equipment. Table 3 summarizes the changes in the District's property, plant and equipment between 2002 and 2003.

**TABLE 3**  
**Capital Assets**  
**(In Thousands)**

	<b>FY 2003</b>	<b>FY 2002</b>	<b>Dollar Change</b>	<b>Total % Change</b>
Buildings and fixed equipment	<b>\$252,835</b>	\$251,183	\$ 1,652	0.7%
Major moveable equipment	<b>148,748</b>	151,215	(2,467)	(1.6)
Subtotal	<b>401,583</b>	402,398	(815)	(0.2)%
Less accumulated depreciation	<b>(236,237)</b>	(235,575)	(662)	0.3
Land and improvements	<b>11,881</b>	11,602	279	2.4
Construction in progress	<b>1,202</b>	401	801	199.8
Net property, plant, and equipment	<b>\$178,429</b>	\$178,826	\$ (397)	(0.2)%

Net property, plant, and equipment declined due to retirement of assets replaced and asset depreciation exceeding the amount of acquisitions.

The District's capital budget for fiscal year 2004 anticipates an investment of \$45 million for capital projects that includes \$11.6 million for facility renovations and expansions, \$9.2 million for information technology projects, and \$23.5 million specific to medical equipment replacement and expansion.

At February 28, 2003, the District had \$152 million in outstanding revenue bonds, net of any discounts, premiums, and deferred refunding losses. The refunding revenue bonds were issued in 1990 for facility expansions and refinanced in 2000. The proceeds of the 2000 bonds were used to decrease approximately 54% of the 1990 bonds and to increase the debt service reserve funds. Moody's and S&P have maintained an underlying rating of Baa2/A- on the District's revenue bond obligations. The debt is insured by MBIA Insurance Corporation and carries Aaa/AAA ratings by both Moody's and S&P. The debt is scheduled to be paid off in 2016. All debt is issued in the name of the Harris County Hospital District. Any issuance of debt requires the approval of Harris County Commissioners' Court. Table 4 below summarizes the District debt obligations at the end of fiscal 2003 and fiscal 2002.

**TABLE 4**  
**Long-Term Debt and Capital Leases**  
**(In Thousands)**

	<b>2003</b>	<b>2002</b>
Series 1990 revenue bonds, net of discount	<b>\$ 54,073</b>	\$ 59,555
Series 2000 revenue bonds, including premium and deferred loss on refunding	<b>98,241</b>	97,814
Capital leases	<b>2,830</b>	–
Total long-term debt and capital leases	<b>155,144</b>	157,369
Less current portion	<b>6,503</b>	5,590
Noncurrent portion	<b>\$ 148,641</b>	\$ 151,779

**Current Budget**

Annually, the District prepares a budget for approval by the Board of Managers and for submission to the Commissioners' Court for approval prior to the beginning of the operating year. The budget is updated as needed for internal management and in 2003 was amended during the District's mid-year review with the Commissioners' Court. Table 5 presents the budget as originally submitted, as amended, and the amended budget as compared to fiscal 2003 actual.

**TABLE 5**  
**Budget vs. Actual**  
**(In Thousands)**

	<b>Original Budget</b>	<b>Amended Budget</b>	<b>Actual FY 2003</b>	<b>Variance</b>
Revenue:				
Net patient service revenue	\$228,919	\$231,951	<b>\$220,317</b>	\$(11,634)
Disproportionate Share III and UPL	54,900	79,100	<b>99,245</b>	20,145
Premiums revenue	32,386	48,983	<b>65,865</b>	16,882
Other operating revenue	11,150	9,178	<b>10,315</b>	1,137
Nonoperating revenue	345,344	337,330	<b>346,390</b>	9,060
Total revenue	672,699	706,542	<b>742,132</b>	35,590

	<b>Original Budget</b>	<b>Amended Budget</b>	<b>Actual FY 2003</b>	<b>Variance</b>
Operating expenses:				
Salaries, wages, and benefits	303,003	313,636	<b>319,700</b>	6,064
Purchased services and supplies	262,441	262,782	<b>253,297</b>	(9,485)
Medical claims expense	26,504	41,927	<b>57,385</b>	15,458
Depreciation and amortization	26,500	26,500	<b>25,433</b>	(1,067)
Interest	12,000	12,000	<b>10,482</b>	(1,518)
Total operating expenses	630,448	656,845	<b>666,297</b>	9,452
Income before restricted contributions	42,251	49,697	<b>75,835</b>	26,138
Restricted contributions	–	–	<b>48</b>	48
Change in net assets	\$ 42,251	\$ 49,697	<b>\$ 75,883</b>	\$ 26,186

In comparing the past year’s financial results to the amended budget, the following items are noted.

Upon completion of the year, total revenues exceed the amended budget by approximately \$36 million. Monies received related to the DSH and UPL programs exceeded the revised budget by more than \$20 million and premium revenues exceeded the revised budget by almost \$17 million.

Actual operating expenses were more in line with the revised budget overall. However, medical claims expense was \$15 million greater than anticipated in line with the growth in HMO membership that created a proportional increase in premium revenues.

Property taxes, net of reserves and administration/collection fees exceeded the revised budget by \$5 million. The District was also able to exceed the budgeted investment income by approximately \$4 million.

### **Economic Conditions and Plan for Fiscal 2004**

In planning for fiscal 2004, of primary concern was the uncertain status of the economy at both the federal and state funding levels. Issues that need to be addressed on an ongoing basis throughout the year include:

- Medicaid cuts
- Effect of privacy legislation (“HIPAA”)
- Increased number of uninsured and working poor and the capacity of the District’s system at both a physical plant capacity level and staffing availability level
- Plant and equipment needs for replacement of aged equipment and needed repairs, maintenance, and renovation

- Future funding available under the DSH and UPL programs.

### **Contacting District Financial Management**

The financial report is designed to provide the taxpayers and the District's customers, creditors, and suppliers with a general overview of the District's finances and to demonstrate the District's accountability for the funds it receives. If you have questions about this report or need additional financial information, contact the District's financial offices as follows:

By Mail:

Harris County Hospital District  
2525 Holly Hall  
Houston, Texas 77054  
Attention: Chief Financial Officer

By Fax:

Harris County Hospital District  
Attention: Chief Financial Officer  
713.566.6796

## Report of Independent Auditors

Board of Managers  
Harris County Hospital District

We have audited the accompanying combined statements of net assets of the Harris County Hospital District and Affiliate (the "District"), a component unit of Harris County, Texas, as of February 28, 2003 and 2002, and the related statements of revenue, expenses, and changes in net assets, 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 the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the 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, 2003 and 2002, and the changes in financial position and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States.

As discussed in Note 2 to the combined financial statements, effective March 1, 2002, the District changed its accounting policy related to financial statement presentation to comply with the provisions of Statement No. 34 of the Governmental Accounting Standards Board.

Management's discussion and analysis on pages i through ix is not a required part of the combined financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have issued a report dated May 21, 2003, on our consideration for the District's internal control over financial reporting and our tests of its compliance with certain provisions of 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.

*Ernst & Young LLP*

May 21, 2003

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

Combined Statements of Net Assets

	February 28	
	2003	2002
	<i>(In Thousands)</i>	
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 56,319	\$ 47,601
Short-term investments	236,768	192,939
Accounts receivable, net of allowance for uncollectible accounts of \$171,744 in 2003 and \$166,615 in 2002	47,530	46,565
Current portion of ad valorem taxes receivable, net of allowance for uncollectible taxes of \$3,346 in 2003 and \$3,194 in 2002	23,406	20,967
Inventories	4,954	4,434
Prepaid expenses and other current assets	24,788	7,755
Current portion of assets limited as to use <i>(Note 5)</i>	6,425	6,023
Total current assets	400,190	326,284
Assets limited as to use or restricted, net of current portion <i>(Note 5)</i> :		
Debt service	81,397	84,806
Other	908	860
	82,305	85,666
Property, plant, and equipment <i>(Note 6)</i> :		
Buildings and fixed equipment	252,835	251,183
Major movable equipment	148,748	151,215
Less accumulated depreciation	(236,237)	(235,575)
	165,346	166,823
Land and improvements	11,881	11,602
Construction in progress	1,202	401
	178,429	178,826
Other assets:		
Ad valorem taxes receivable, net of current portion and allowance for uncollectible taxes of \$50,190 in 2003 and \$51,254 in 2002	6,213	5,156
Net pension asset <i>(Note 8)</i>	2,517	2,703
Deferred bond issue costs, net of accumulated amortization of \$6,670 in 2003 and \$6,281 in 2002	3,213	3,602
	11,943	11,461
Total assets	\$ 672,867	\$ 602,237

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

Combined Statements of Net Assets (continued)

	February 28	
	2003	2002
	<i>(In Thousands)</i>	
<b>Liabilities and net assets</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 45,124	\$ 53,860
Interest payable	431	448
Employee compensation and related benefit liabilities	10,029	14,972
Compensated absences	16,152	15,058
Medical claims liability	16,789	5,728
Estimated third-party payor settlements	1,077	2,564
Notes payable <i>(Note 7)</i>	24,251	24,251
Current portion of long-term debt and capital leases <i>(Note 7)</i>	6,503	5,590
Total current liabilities	120,356	122,471
Long-term debt <i>(Note 7)</i> :		
Series 1990 revenue bonds, net of discount of \$467 in 2003 and \$575 in 2002	48,063	53,965
Series 2000 revenue bonds, including premium of \$2,741 in 2003 and \$3,004 in 2002 and deferred loss on refunding of \$4,580 in 2003 and \$5,270 in 2002	98,241	97,814
Other long-term obligation	2,337	—
Total liabilities	268,997	274,250
Net assets:		
Invested in capital assets, net of related debt	12,473	10,645
Restricted net assets	36,002	33,549
Unrestricted net assets	355,395	283,793
Total net assets	403,870	327,987
Commitments and contingencies <i>(Note 10)</i>		

Total liabilities and net assets	\$ 672,867	\$ 602,237
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*See accompanying notes.*

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

Combined Statements of Revenue, Expenses, and Changes in Net Assets

	<b>Year ended February 28</b>	
	<b>2003</b>	<b>2002</b>
	<i>(In Thousands)</i>	
Operating revenue:		
Net patient service revenue <i>(Note 3)</i>	\$ 220,317	\$ 196,999
DSH/UPL <i>(Note 4)</i>	99,245	49,611
Premium revenue	65,865	26,738
Other operating revenue	10,315	9,635
Total operating revenue	<u>395,742</u>	<u>282,983</u>
Operating expenses:		
Salaries, wages, and benefits	319,700	286,565
Pharmaceuticals and supplies	105,547	102,639
Physician services	88,714	81,616
Medical claims expense	57,385	20,984
Other purchased services	59,036	55,945
Depreciation and amortization	25,433	24,645
Interest	10,482	11,624
Total operating expenses	<u>666,297</u>	<u>584,018</u>
Operating loss	<u>(270,555)</u>	<u>(301,035)</u>
Nonoperating revenues:		
Net ad valorem tax revenues	330,140	313,303
Net tobacco settlement revenue	4,592	7,114
Investment income	11,658	12,038
Income before contributions	<u>75,835</u>	<u>31,420</u>
Capital contributions, net	48	9
Change in net assets	<u>75,883</u>	<u>31,429</u>
Total net assets – beginning of year	<u>327,987</u>	<u>296,558</u>
Total net assets – end of year	<u><u>\$ 403,870</u></u>	<u><u>\$ 327,987</u></u>

*See accompanying notes.*

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

Combined Statements of Cash Flows

	<b>Year ended February 28</b>	
	<b>2003</b>	<b>2002</b>
	<i>(In Thousands)</i>	
<b>Operating activities</b>		
Cash received from customers	\$ 295,532	\$ 222,481
Cash received from DSH/UPL	83,777	49,611
Cash payments for medical claims	(46,324)	(19,801)
Cash payments for goods and services	(265,419)	(232,831)
Cash payments to employees	(323,549)	(283,850)
Net cash used in operating activities	<u>(255,983)</u>	<u>(264,390)</u>
<b>Noncapital financing activities</b>		
Proceeds from restricted contributions	48	9
Net ad valorem taxes received	326,646	311,365
Net tobacco settlement received	4,592	7,114
Net cash provided by noncapital financial activities	<u>331,286</u>	<u>318,488</u>
<b>Capital and related financing activities</b>		
Acquisitions and construction of capital assets, net of deletions	(21,019)	(30,381)
Proceeds from Commercial Paper	-	11,863
Interest paid	(10,762)	(11,466)
Repayment of long-term debt	(5,590)	(5,195)
Net cash used in capital and related financing activities	<u>(37,371)</u>	<u>(35,179)</u>
<b>Investing activities</b>		
Receipts of interest income and realized gains and losses	11,656	12,415
Purchase of investment securities	(247,588)	(215,131)
Proceeds from sale and maturities of investment securities	203,759	155,270
Decrease in assets limited as to use	2,959	12,717
Net cash used in investing activities	<u>(29,214)</u>	<u>(34,729)</u>
Net increase (decrease) in cash and cash equivalents	8,718	(15,810)
Cash and cash equivalents at beginning of year	47,601	63,411
Cash and cash equivalents at end of year	<u>\$ 56,319</u>	<u>\$ 47,601</u>
<b>Schedule of noncash capital and related financing activities:</b>		
Assets acquired through capital lease	\$ (2,830)	\$ -
Capital lease liability	\$ 2,830	\$ -

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

Combined Statements of Cash Flows (continued)

	<b>Year ended February 28</b>	
	<b>2003</b>	<b>2002</b>
	<i>(In Thousands)</i>	
Reconciliation of operating loss to net cash used in operating activities:		
Operating loss	\$ (270,555)	\$ (301,035)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Interest expense on capital financing	10,482	11,197
Depreciation and amortization expense	25,433	24,645
Changes in operating assets and liabilities:		
(Increase) in accounts receivable	(965)	(1,256)
(Increase) decrease in inventories	(520)	15
(Increase) in prepaid expenses and other assets	(17,033)	(3,508)
Decrease in net pension asset	186	201
(Decrease) increase in accounts payable and accrued liabilities	(8,736)	3,496
(Decrease) increase in employee compensation and related benefit liabilities	(4,943)	1,624
Increase in compensated absences	1,094	1,090
Increase in medical claims liability	11,061	1,183
(Decrease) in estimated third-party payor settlements	(1,487)	(2,042)
	<u>14,572</u>	<u>36,645</u>
Net cash used in operating activities	<u>\$ (255,983)</u>	<u>\$ (264,390)</u>

*See accompanying notes.*

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

Notes to Combined Financial Statements

February 28, 2003

**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 property taxes levied by Harris County for the provision of this care. The District operates two acute care hospitals, a hospital-based skilled nursing and rehabilitation facility 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 others 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, 2003, the HMO had approximately 37,845 enrollees. The HMO offers one Medicaid product.

**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)**

**Method of Accounting**

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.

On March 1, 2002, the District adopted the provisions of Statement No. 34 of the Governmental Accounting Standards Board ("GASB 34"), *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*. GASB 34 established standards for external financial reporting for all state and local governmental entities. These standards require three financial statements that include a Statement of Net Assets, a Statement of Revenue, Expenses, and Change in Net Assets, and a Statement of Cash Flows. Previous cash flow statements were prepared using the indirect method. GASB 34 requires use of the direct method.

The Statement of Net Assets requires that total net assets be reported in three components: (1) invested in capital assets, net of related debt, (2) restricted, and (3) unrestricted.

- "Invested in capital assets, net of related debt" consists of capital assets, including restricted capital assets, net of accumulated depreciation, reduced by the amount outstanding for any bonds, notes, or other financing liabilities that were incurred related to the acquisition, construction, or improvement of the capital assets.
- "Restricted net assets" consists of assets that are restricted as to use by external factors such as debt covenants, grantors, contributors, or laws or regulations of other governments or legislation.
- "Unrestricted net assets" consists of net assets that do not meet the definitions above for "invested in capital assets, net of related debt" or "restricted net assets."

The adoption of GASB 34 had the following changes in presentation on the financial statements. Net assets are categorized in accordance with this statement rather than presenting fund balance components. Restricted contributions are reflected as a line item

Harris County Hospital District and Affiliate, a  
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Notes to Combined Financial Statements (continued)

**2. Summary of Significant Accounting Policies (continued)**

in the statement detailing the changes in net assets. The provision for doubtful accounts or bad debt expense is no longer presented as an operating expense but is reflected in net patient service revenues as a revenue deduction. In addition, revenues from property taxes, investment income, and tobacco settlement funds have been reclassified from operating revenues to nonoperating revenues.

**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.

**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.

**Inventories**

Inventories are valued at the lower of cost, using the first-in, first-out method, 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.

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)**

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**

The District maintains a paid time-off plan. 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%.

**Statements of Revenue, Expenses, and Changes in Net Assets**

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

**Net Patient Service Revenue**

Net patient service revenue is 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.

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 set by the Federal Department of Health and Human Services and considers the size of the patient's family unit.

**Premium Revenue**

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.

Medical claims expense reserves represent the estimated ultimate net cost of all reported and unreported losses incurred through February 28. The reserves for unpaid medical claims expenses are actuarially estimated using individual case-basis valuations and statistical analyses. Those estimates are subject to the effects of trends in loss severity and frequency. Although considerable variability is inherent in such estimates, management believes the reserves for medical claims expenses are adequate. The estimates are continually reviewed and adjusted as necessary as experience develops or new information becomes known; such adjustments are included in current operations.

Harris County Hospital District and Affiliate, a  
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Notes to Combined Financial Statements (continued)

**2. Summary of Significant Accounting Policies (continued)**

Changes in the HMO's aggregate liability for medical claims in fiscal years 2003 and 2002 were as follows:

<b>Year Ended February 28</b>	<b>Beginning of Fiscal Year Liability</b>	<b>Current Year Claims and Changes in Estimates</b>	<b>Claim Payments</b>	<b>Balance at Fiscal Year- End</b>
	<i>(In Thousands)</i>			
2003	\$ 5,728	\$ 57,385	\$ 46,324	\$ 16,789
2002	4,545	20,984	19,801	5,728

**Ad Valorem Tax Revenues**

Ad valorem tax revenues are recorded in the year for which the taxes are levied, net of provisions for uncollectible amounts, collection expenses, and appraisal fees. Harris County Commissioners' Court levies a tax for the District as provided under state law. The taxes are collected by the Harris County Tax Assessor Collector and are remitted to the District as received. Taxes are levied and become collectible from October 1 to January 31 of the succeeding year. 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 \$4,592,000 associated with the settlement in fiscal year 2003. Settlement revenues for fiscal year 2004 and beyond will be based on the investment earnings of the tobacco settlement fund as administered by the Comptroller's Office of the State of Texas. The District is unable to estimate the continuance or level of future distributions.

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)**

**Reclassifications**

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

**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.

**3. Net Patient Service Revenue**

Net patient service revenue is composed of the following:

	<b>Year ended February 28</b>	
	<b>2003</b>	<b>2002</b>
	<i>(In Thousands)</i>	
Gross patient service revenue, net of charity care provided	<b>\$ 559,723</b>	\$ 510,764
Deductions from revenue:		
Contractual allowance:		
Medicare	<b>46,126</b>	26,319
Medicaid	<b>85,107</b>	78,393
Managed Medicaid	<b>30,187</b>	22,327
Provision for bad debt expense	<b>162,529</b>	174,168
Other discounts	<b>15,457</b>	12,558
Net patient service revenue	<b>\$ 220,317</b>	\$ 196,999

Charity care provided during the years ended February 28, 2003 and 2002, measured at established rates, totaled \$391,930,000 and \$303,762,000, respectively. These charges are not included in net patient service revenues.

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

Notes to Combined Financial Statements (continued)

**3. Net Patient Service Revenue (continued)**

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. Medicare outpatient services are reimbursed on a prospective basis through ambulatory payment classifications, which are based on clinical resources used in performing the procedures. The District's Medicare cost reports have been audited by the Medicare fiscal intermediary through February 28, 1999.

**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, 1995.

Cash received from the Medicare program accounted for approximately 22% and 24% of the District's total cash collections for patient service revenues for the years ended February 28, 2003 and 2002, respectively. Cash received from the Medicaid program (including managed Medicaid) accounted for approximately 56% and 51% of the District's total cash collections for patient service revenues for the years ended February 28, 2003 and 2002, respectively.

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

Notes to Combined Financial Statements (continued)

**3. Net Patient Service Revenue (continued)**

Laws 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 and Upper Payment Limit Programs**

The Disproportionate Share III Program (“DSH”) was created in fiscal year 1992 by the state of Texas to access additional federal matching funds. These funds are distributed to selected hospitals that provide services to low-income and uninsured patients. The District received DSH revenues of \$26,586,000 and \$49,611,000 during the years ended February 28, 2003 and 2002. 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.

The Upper Payment Limit program (“UPL”) was created in May of 2002 with an effective date of July 2001. The UPL program uses Federal matching funds to raise State Medicaid reimbursement rates to 100% of equivalent Medicare rates for certain public hospital systems. In fiscal 2003, the District received \$32,181,000 in revenue related to fiscal year 2002. The 2002 amounts are included in fiscal 2003 due to the timing of the approval of the program. The District has received \$72,659,000 under the UPL program.

**5. 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. The carrying amount of cash, time deposits, corporate discount notes, and

Harris County Hospital District and Affiliate, a  
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Notes to Combined Financial Statements (continued)

**5. Assets Limited as to Use (continued)**

commercial paper approximates fair value. The fair value of governmental securities is based on quoted market prices as of February 28, 2003 and 2002. The following table sets forth the components of assets limited as to use at fair value at February 28, 2003:

<b>Description of Assets</b>	<b>Total</b>	<b>Debt Service</b>	<b>Other</b>
	<i>(In Thousands)</i>		
Cash and time deposits	\$ 2,156	\$ 1,248	\$ 908
Government securities	86,574	86,574	-
	<b>88,730</b>	<b>87,822</b>	<b>908</b>
Less funds required for current liabilities	6,425	6,425	-
	<b>\$ 82,305</b>	<b>\$ 81,397</b>	<b>\$ 908</b>

The following table sets forth the components of assets limited as to use at fair value at February 28, 2002:

<b>Description of Assets</b>	<b>Total</b>	<b>Debt Service</b>	<b>Other</b>
	<i>(In Thousands)</i>		
Cash and time deposits	\$ 1,246	\$ 386	\$ 860
Government securities	90,443	90,443	-
	91,689	90,829	860
Less funds required for current liabilities	6,023	6,023	-
	<b>\$ 85,666</b>	<b>\$ 84,806</b>	<b>\$ 860</b>

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

Notes to Combined Financial Statements (continued)

**6. Property, Plant, and Equipment**

The District's investment in property, plant, and equipment consists of the following as of February 28, 2003:

	<b>Beginning Balance</b>	<b>Additions/ Transfers</b>	<b>Retirements/ Transfers</b>	<b>Ending Balance</b>
<i>(In Thousands)</i>				
Land and land improvements	\$ 11,602	\$ 288	\$ (9)	\$ 11,881
Building and improvements	251,183	1,738	(86)	252,835
Equipment	151,215	22,506	(24,973)	148,748
Total at historical cost	414,000	24,532	(25,068)	413,464
Less accumulated depreciation	(235,575)	(24,246)	23,584	(236,237)
Construction in progress	401	2,446	(1,645)	1,202
Property, plant, and equipment, net	\$ 178,826	\$ 2,732	\$ (3,129)	\$ 178,429

**7. 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

Harris County Hospital District and Affiliate, a  
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Notes to Combined Financial Statements (continued)

**7. Long-Term Debt (continued)**

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 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 \$4,580,000 at February 28, 2003. 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, 2003. Principal amounts of total defeased indebtedness outstanding at February 28, 2003, are \$46,613,000. The fair market value of the 1990 and 2000 Bonds outstanding at February 28, 2003, based on quoted market prices, is approximately \$178,216,000.

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 on the bonds are as follows:

2004	\$ 6,010
2005	6,485
2006	6,965
2007	7,490
2008	8,055
Thereafter	<u>119,615</u>
Total	<u>\$ 154,620</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-Thuringen Girozentrale, Helaba Bank. At February 28, 2003, notes outstanding were \$24,251,000.

Harris County Hospital District and Affiliate, a  
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Notes to Combined Financial Statements (continued)

**7. Long-Term Debt (continued)**

**Tax and Revenue Anticipation Notes**

In October 2001, the District entered into an offering memorandum for issuance of Series 2001 Tax and Revenue Anticipation Notes (the "Notes"). The Notes were authorized to a maximum outstanding of \$55,000,000. Under this agreement the District accessed interim financing totaling \$55,151,251. The notes were repaid prior to February 28, 2002 from ad valorem tax receipts.

**8. Employee Benefit Plans**

*Pension Plan*

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)

**8. Employee Benefit Plans (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 2003, the District's annual pension cost was \$3,311,708, and the net pension asset was \$2,516,789.

<b>Fiscal Year Ending</b>	<b>Annual Pension Cost (APC)</b>	<b>Percentage of APC Contributed</b>	<b>Net Pension Asset</b>
02/28/03	\$ <b>3,311,708</b>	<b>94.39%</b>	\$ <b>(2,516,789)</b>
02/28/02	\$ 3,934,353	94.91%	\$ (2,703,404)
02/28/01	\$ 4,976,819	0.00%	\$ (2,903,856)

The plan is on a calendar year-end, and the actuarially-determined contribution requirement intended to cover normal cost was approximately \$3,126,000 (1.9% of January 1, 2002 covered payroll) and \$3,734,000 (2.5% of January 1, 2001 covered payroll) for the years ended December 31, 2002 and 2001, respectively.

During the year ended February 28, 2003, the District made cash contributions of \$3,125,903 to the pension trust. Pension expense recognized in the Combined Statements of Revenue, Expenses, and Changes in Net Assets was \$3,512,970 and \$3,733,901 for the years ended February 28, 2003 and 2002, respectively.

*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, 2003 and 2002, those costs were approximately \$4,731,000 and \$4,131,000, respectively. The number of retirees and beneficiaries eligible to receive the benefits was 1,597 at January 1, 2002.

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

Notes to Combined Financial Statements (continued)

**8. Employee Benefit Plans (continued)**

*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 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 \$11,000 and \$10,500 during calendar years 2003 and 2002, respectively, for participants under the age of 50. Contributions to the Plan cannot exceed the statutory maximum of \$12,000 during calendar year 2002 for participants over the age of 50. The plan is a governmental plan and, as such, is specifically exempt from the reporting and disclosure requirements of Title I of ERISA. Total contributions made by participants for the years ended December 31, 2002 and 2001 were \$8,657,000 and \$7,764,000, respectively.

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.

*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 Statements of Net Assets, remain the District's property until paid or made available to participants. The plan assets at February 28, 2003 and 2002 were approximately \$14,532,000 and \$13,994,000, respectively. A corresponding liability to the participants of an equal amount exists at February 28, 2003 and 2002.

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

Notes to Combined Financial Statements (continued)

**9. 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 (see Note 2). Patient service revenues (see Note 3) and the related accounts receivable are reflected in the District's combined financial statements net of charges for charity care provided. The mix of net receivables from self-pay patients and third-party payors at February 28, 2003 and 2002 is as follows:

	<b>2003</b>	<b>2002</b>
Medicaid	<b>57%</b>	53%
Medicare	<b>15</b>	15
Commercial and self-pay patients	<b>28</b>	32
	<b>100%</b>	100%

**10. 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, 2003 that may result in the assertion of additional claims. The District covers its exposure for asserted and unasserted claims through a program of self-insurance and has accrued its best estimate of these contingent losses. 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, 2003, the District had commitments outstanding in the amount of approximately \$3,433,000 related to improvements at existing facilities.

The District had rental expenses related to its operating leases of approximately \$4,241,000 and \$3,200,000 during the years February 28, 2003 and 2002, respectively.

Harris County Hospital District and Affiliate, a  
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Notes to Combined Financial Statements (continued)

**10. Commitments and Contingencies (continued)**

The District has a self-insurance program that provides for the payment of workers' compensation claims. The funding for this program is based on an actuarial evaluation, using a 5% discount rate. Changes in the District's liability for workers' compensation claims were as follows for the years ended December 31 (the date of the actuarial evaluations):

<b>Year Ended</b>	<b>Beginning of Year Liability</b>	<b>Current Year Claims and Changes in Estimates</b>	<b>Claim Payments</b>	<b>End of Year Liability</b>
2002	\$ 8,160	\$ 2,975	\$ 3,279	\$ 7,856
2001	8,015	3,070	2,925	8,160

The District has recorded liabilities related to workers' compensation of approximately \$8,471,000 and \$8,774,000 at February 28, 2003 and 2002, respectively. These liabilities are included in accounts payable and accrued liabilities in the accompanying Statements of Net Assets.

Additional 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, 2002

<b>Valuation Date</b>	<b>Actuarial Value of Assets (AVA)</b>	<b>Actuarial Accrued Liability (AAL)</b>	<b>Overfunded Actuarial Accrued Liability (OAAL) (2) – (3)</b>	<b>Funded Ratio (2)/(3)</b>	<b>Annual Covered Payroll</b>
<b>(1)</b>	<b>(2)</b>	<b>(3)</b>	<b>(4)</b>	<b>(5)</b>	<b>(6)</b>
January 1, 2000	\$ 297,517	\$ 260,580	\$ 36,937	114.2%	\$ 137,552
January 1, 2001	\$ 309,136	\$ 268,617	\$ 40,519	115.1%	\$ 148,462
January 1, 2002	\$ 302,390	\$ 289,414	\$ 12,976	104.5%	\$ 164,548

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*.

Harris County Hospital District and Affiliate, a  
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Schedule of Actuarial Data for Pension Plan

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, 2002
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.