

COMBINED FINANCIAL STATEMENTS

Harris County Hospital District and Affiliate, a Component Unit of  
Harris County, Texas  
Years ended February 29, 2004 and February 28, 2003, with Report of  
Independent Auditors

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

Combined Financial Statements

Years ended February 29, 2004 and February 28, 2003

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## Management's Discussion and Analysis

This section of the Harris County Hospital District's (the "District") financial report presents background information and our analysis of the District's financial results for the fiscal year March 1, 2003 through February 29, 2004. Please read this section in conjunction with the District's combined financial statements, which begin on page 3.

### Financial Highlights

- The District's net assets increased \$34 million, or 8.4%, given the income reported for the year.
- During the year, the District's net operating revenue increased \$71.8 million while expenses increased \$120.6 million over the prior year. Patient service revenues provided an additional \$20.5 million in funding and the Disproportionate Share ("DSH") program and the Upper Payment Limit ("UPL") program provided the District with an additional \$11.5 million in funding for patient services for fiscal 2004. Prepaid health premiums increased \$39 million, or 59%, in fiscal 2004 given a 198% increase in member months. Premium revenues grew at a slower rate than membership due to a shift toward groups with lower premiums.
- Taxes generated an additional \$15.9 million while the District experienced a slight increase of \$0.5 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:
  - Coordinated EPIC clinical care systems implementation,
  - PeopleSoft general ledger; accounts payable, materials management, and purchasing systems software and implementation (ERPS – Enterprise Resource Planning System),
  - Replacement equipment for maternal fetal monitors, ultrasound systems, IV pumps, sterilization equipment, anesthesia workstations, radiology and imaging diagnostics, infant warmers, multi-channel infusion pumps, surgical equipment, radiographic fluoroscopy systems, and resuscitation carts,
  - Pharmacy equipment and automated inventory and dispensing systems,
  - Laboratory gravity sterilizer,
  - Ventilators and ventilator software,

- Space expansions and renovations for Ben Taub’s pharmacies and emergency center and the Baytown Health center,
- Boiler and chiller replacement projects,
- Paging system,
- Information technology, including network software, desktop PC upgrades, server for the Enterprise Resource Planning System, Oracle database, and analytical tools, and
- CT scanners for LBJ and Ben Taub hospitals.

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 nonfinancial 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 1 below:

**TABLE 1**  
**Condensed Summary of Assets and Liabilities**  
**(In Millions)**

	<b>FY 2004</b>	<b>FY 2003</b>	<b>Dollar Change</b>	<b>Total % Change</b>
Current and other assets	\$ 538	\$ 495	\$ 43	9%
Capital assets	185	178	7	4
Total assets	<u>\$ 723</u>	<u>\$ 673</u>	<u>\$ 50</u>	<u>7%</u>
Long-term debt outstanding	\$ 142	\$ 149	\$ (7)	(5)%
Other liabilities	143	120	23	19
Total liabilities	<u>\$ 285</u>	<u>\$ 269</u>	<u>\$ 16</u>	<u>6%</u>
Invested in capital assets, net of related debt	\$ 25	\$ 12	\$ 13	108%
Restricted	36	36	—	—
Unrestricted	377	356	21	6
Total net assets	<u>\$ 438</u>	<u>\$ 404</u>	<u>\$ 34</u>	<u>8%</u>

As can be seen in Table 1, net assets increased \$34 million in fiscal year 2004. The change in net assets is primarily the result of increased operating revenues. Net patient services revenues and premium revenues increased \$20.5 million and \$39 million, respectively, as compared to fiscal 2003. Additionally, the District's revenues from the DSH and UPL programs were approximately \$111 million this year compared to \$99 million last year.

## 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 29, 2004 and February 28, 2003, 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>2004</b>	<b>2003</b>
Operating revenue:		
Net patient service revenue	<b>\$ 240,858</b>	\$ 220,317
Disproportionate Share III and Upper Payment Limit	<b>110,769</b>	99,245
Premium revenues	<b>104,586</b>	65,632
Other operating revenues	<b>12,020</b>	11,279
Total operating revenues	<b>468,233</b>	396,473
Operating expenses:		
Salaries, wages, and benefits	<b>373,570</b>	319,700
Purchased services and supplies	<b>283,847</b>	253,165
Medical claims expenses	<b>90,168</b>	57,284
Depreciation and amortization	<b>28,890</b>	25,433
Interest expense	<b>10,179</b>	10,482
Total operating expenses	<b>786,654</b>	666,064
Operating loss	<b>(318,421)</b>	(269,591)
Nonoperating revenue	<b>352,488</b>	345,426
Restricted contributions	<b>160</b>	48
Change in net assets	<b>34,227</b>	75,883
Total net assets – beginning of year	<b>403,870</b>	327,987
Total net assets – end of year	<b>\$ 438,097</b>	\$ 403,870

The District's net patient service revenue increased \$20.5 million in 2004 as a result of continued improvements throughout the revenue cycle, including rate increases, better identification of third-party payors, improved charge capture, and billing and collections.

Revenues from the Disproportionate Share III and Upper Payment Limit programs increased \$11.5 million. Fiscal 2003 was the first year that the District received funds from the UPL program that began in July 2001. The District is unable to estimate the continuance or amount of future funding of the UPL program. As of February 29, 2004, the District has not received any funds related to the State of Texas September 2003 – August 2004 UPL program. The District has recorded a \$28.7 million receivable at February 29, 2004, related to the DSH and UPL programs.

The District recognized premium revenue through its not-for-profit HMO subsidiary, Community Health Choice, Inc. Premium revenue increased \$39 million due to a tripling in member months. Revenue grew less rapidly due to a shift toward member groups with lower premiums.

Salaries and wages increased \$31.8 million, or 11%, 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 \$22.1 million, or 43%, primarily in the areas of pension expense and employee medical benefits.

Overall, purchased services and supplies increased \$30.7 million, or 12%. Physician service costs were \$8.9 million, or 10% 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 maintenance and repairs, \$0.9 million more for utilities, and \$1.5 million more than prior year in other nonclinical purchased services. The cost of supplies increased 15.6%, or \$16.4 million, primarily in pharmaceutical costs, an increase of \$10.1 million, and the remainder in medical operating supplies.

Medical claims expense associated with the HMO increased by \$32.9 million due to a growth in membership during the year.

Overall, the District's operating loss increased \$48.8 million, or 18%. 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, tobacco settlement monies, and gains or losses on disposal of assets. Tax revenues increased \$15.9 million, or 4.8%, as a result of increased property values. Investment income declined approximately 55% due to declining market rates during the year and the requirement to reflect certain securities at market value. In fiscal 2004, the District received approximately \$5 million in tobacco settlement revenues as compared to \$4.6 million in 2003. Loss on disposal of assets increased due to write-off of previously capitalized software development costs related to a discontinued project.

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

During fiscal 2004, the District has invested \$38.4 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 2003 and 2004.

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

	<b>FY 2004</b>	<b>FY 2003</b>	<b>Dollar Change</b>	<b>Total % Change</b>
Land and improvements	<b>\$ 11,818</b>	\$ 11,881	\$ (63)	(.5)%
Buildings and fixed equipment	<b>256,126</b>	252,835	3,291	1.3
Major moveable equipment	<b>161,583</b>	148,748	12,835	8.6
Subtotal	<b>429,527</b>	413,464	16,063	3.9
Less accumulated depreciation	<b>(249,551)</b>	(236,237)	(13,314)	(5.6)%
Construction in progress	<b>4,933</b>	1,202	3,731	310.4
Net property, plant, and equipment	<b>\$184,909</b>	\$178,429	\$ 6,480	3.6%

The District's capital budget for fiscal year 2005 anticipates an investment of \$32 million for capital projects that includes \$9.5 million for facility renovations and expansions and \$22.5 million specific to medical equipment replacement and expansion. For items related to Information Technology, no new capital funds are budgeted for fiscal year 2005. Funds approved in prior years will fulfill current-year requirements.

At February 29, 2004, the District had \$147 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 were refinanced in 2000. The proceeds of the 2000 bonds were used to defease approximately 54% of the 1990 bonds and to increase the debt service reserve funds. Moody's and Standard & Poor's 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 Standard & Poor's. 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 2004 and fiscal 2003.

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

	<u>2004</u>	<u>2003</u>
Series 1990 revenue bonds, net of discount	\$ 48,143	\$ 54,073
Series 2000 revenue bonds, including premium and deferred loss on refunding	98,575	98,241
Capital leases	<u>2,358</u>	<u>2,830</u>
Total long-term debt and capital leases	<u>149,076</u>	155,144
Less current portion	<u>(6,968)</u>	<u>(6,503)</u>
Noncurrent portion	<u>\$ 142,108</u>	<u>\$ 148,641</u>

**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 2004 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 2004 actual.

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

	<b>Original Budget</b>	<b>Amended Budget</b>	<b>Actual FY 2004</b>	<b>Favorable (Unfavorable) Variance</b>
Revenue:				
Net patient service revenue	\$244,212	\$244,212	<b>\$240,858</b>	\$ (3,354)
Disproportionate Share III and UPL	73,785	103,051	<b>110,769</b>	7,718
Premium revenue	97,463	97,463	<b>104,586</b>	7,123
Other operating revenue	13,169	13,169	<b>12,020</b>	(1,149)
Nonoperating revenue	356,778	357,226	<b>352,488</b>	(4,738)
Total revenue	<u>785,407</u>	<u>815,121</u>	<b>820,721</b>	5,600

	<b>Original Budget</b>	<b>Amended Budget</b>	<b>Actual FY 2004</b>	<b>Favorable (Unfavorable) Variance</b>
Operating expenses:				
Salaries, wages, and benefits	357,607	369,233	<b>373,570</b>	(4,337)
Purchased services and supplies	283,694	292,243	<b>283,847</b>	8,396
Medical claims expense	85,867	85,867	<b>90,168</b>	(4,301)
Depreciation and amortization	26,500	26,500	<b>28,890</b>	(2,390)
Interest	11,205	11,205	<b>10,179</b>	1,026
Total operating expenses	764,873	785,048	<b>786,654</b>	(1,606)
Income before restricted contributions	20,534	30,073	<b>34,067</b>	3,994
Restricted contributions	–	–	<b>160</b>	160
Change in net assets	\$ 20,534	\$ 30,073	\$ <b>34,227</b>	\$ 4,154

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

Upon completion of the year, total revenues exceeded the amended budget by \$5.6 million. Monies received related to the DSH and UPL programs exceeded the revised budget by more than \$7.7 million, and premium revenues exceeded the revised budget by \$7.1 million. Nonoperating revenue fell short of budget by \$4.7 million primarily due to write-off of previously capitalized software development costs related to a discontinued project. Operating revenues were approximately \$1 million less than budget. Net patient service revenues fell \$3.4 million short of the amended budget.

Actual operating costs exceeded the amended budget for most line items. Purchased services and supplies were less than anticipated due to savings in discretionary non-clinical purchased services. Total operating expenses were \$1.6 million more than the amended budget, and the District was able to achieve income almost \$4 million greater than planned.

### **Economic Conditions and Plan for Fiscal 2005**

In planning for fiscal 2005, 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 the following:

- Medicaid cuts
- 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
- Financial planning for the District's 2015 Strategic Plan as adopted by the Board of Managers and approved by the County Commissioners' Court
- Future funding available under the DSH and UPL programs
- Balancing of growing enrollment in the HMO, reductions in Medicaid reimbursement, and rising medical costs

### **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 29, 2004 and February 28, 2003, and the related combined 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 29, 2004 and February 28, 2003, and the changes in their financial position and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States.

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 27, 2004, 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.

May 27, 2004

*Ernst & Young LLP*



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

Combined Statements of Net Assets

	<b>February 29 2004</b>	<b>February 28 2003</b>
<i>(In Thousands)</i>		
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 28,323	\$ 56,319
Short-term investments	289,170	236,768
Accounts receivable, net of allowance for uncollectible accounts of \$182,138 in 2004 and \$171,744 in 2003	58,027	47,530
Current portion of ad valorem taxes receivable, net of allowance for uncollectible taxes of \$3,511 in 2004 and \$3,346 in 2003	27,546	23,406
Inventories	6,840	4,954
Prepaid expenses and other current assets	39,004	24,788
Current portion of assets limited as to use <i>(Note 5)</i>	6,881	6,425
Total current assets	455,791	400,190
Assets limited as to use or restricted, net of current portion <i>(Note 5)</i> :		
Debt service	71,261	81,397
Other	1,068	908
	72,329	82,305
Property, plant, and equipment <i>(Note 6)</i> :		
Land and improvements	11,818	11,881
Buildings and fixed equipment	256,126	252,835
Major movable equipment	161,583	148,748
Less accumulated depreciation	(249,551)	(236,237)
	179,976	177,227
Construction in progress	4,933	1,202
	184,909	178,429
Other assets:		
Ad valorem taxes receivable, net of current portion and allowance for uncollectible taxes of \$51,288 in 2004 and \$50,190 in 2003	6,978	6,213
Net pension asset <i>(Note 8)</i>	-	2,517
Deferred bond issue costs, net of accumulated amortization of \$7,035 in 2004 and \$6,670 in 2003	2,848	3,213
	9,826	11,943
Total assets	\$ 722,855	\$ 672,867

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

Combined Statements of Net Assets (continued)

	<b>February 29 2004</b>	<b>February 28 2003</b>
<i>(In Thousands)</i>		
<b>Liabilities and net assets</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 43,068	\$ 45,124
Interest payable	397	431
Employee compensation and related benefit liabilities	27,119	10,029
Compensated absences	17,655	16,152
Medical claims liability	18,215	16,789
Estimated third-party payor settlements	4,977	1,077
Notes payable <i>(Note 7)</i>	24,251	24,251
Current portion of long-term debt and capital leases <i>(Note 7)</i>	<u>6,968</u>	<u>6,503</u>
Total current liabilities	<b>142,650</b>	120,356
Long-term debt <i>(Note 7)</i> :		
Series 1990 revenue bonds, net of discount of \$387 in 2004 and \$467 in 2003	41,658	48,063
Series 2000 revenue bonds, including premium of \$2,477 in 2004 and \$2,741 in 2003 and deferred loss on refunding of \$3,982 in 2004 and \$4,580 in 2003	98,575	98,241
Other long-term obligation	<u>1,875</u>	<u>2,337</u>
Total liabilities	<b>284,758</b>	268,997
Net assets:		
Invested in capital assets, net of related debt	25,021	12,473
Restricted net assets	36,527	36,002
Unrestricted net assets	<u>376,549</u>	<u>355,395</u>
Total net assets	<b>438,097</b>	403,870
Commitments and contingencies <i>(Note 10)</i>		

Total liabilities and net assets  
*See accompanying notes.*

<b>\$ 722,855</b>	<b>\$ 672,867</b>
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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</b>	
	<b>February 29</b>	<b>February 28</b>
	<b>2004</b>	<b>2003</b>
	<i>(In Thousands)</i>	
Operating revenue:		
Net patient service revenue <i>(Note 3)</i>	<b>\$ 240,858</b>	\$ 220,317
DSH/UPL program revenue <i>(Note 4)</i>	<b>110,769</b>	99,245
Premium revenue	<b>104,586</b>	65,632
Other operating revenue	<b>12,020</b>	11,279
Total operating revenue	<b>468,233</b>	396,473
Operating expenses:		
Salaries, wages, and benefits	<b>373,570</b>	319,700
Pharmaceuticals and supplies	<b>121,988</b>	105,547
Physician services	<b>97,650</b>	88,714
Medical claims expense	<b>90,168</b>	57,284
Other purchased services	<b>64,209</b>	58,904
Depreciation and amortization	<b>28,890</b>	25,433
Interest	<b>10,179</b>	10,482
Total operating expenses	<b>786,654</b>	666,064
Operating loss	<b>(318,421)</b>	(269,591)
Nonoperating revenues:		
Net ad valorem tax revenues	<b>346,018</b>	330,140
Net tobacco settlement revenue	<b>5,012</b>	4,592
Investment income	<b>5,223</b>	11,658
Other	<b>(3,765)</b>	(964)
Income before contributions	<b>34,067</b>	75,835
Capital contributions, net	<b>160</b>	48
Change in net assets	<b>34,227</b>	75,883
Total net assets – beginning of year	<b>403,870</b>	327,987
Total net assets – end of year	<b>\$ 438,097</b>	\$ 403,870

*See accompanying notes.*

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

Combined Statements of Cash Flows

	<b>Year ended</b>	
	<b>February 29</b>	<b>February 28</b>
	<b>2004</b>	<b>2003</b>
	<i>(In Thousands)</i>	
<b>Operating activities</b>		
Cash received from customers	\$ 346,967	\$ 296,263
Cash received from DSH/UPL	97,512	83,777
Cash payments for medical claims	(88,742)	(46,223)
Cash payments for goods and services	(284,848)	(265,287)
Cash payments to employees	(352,460)	(323,549)
Net cash used in operating activities	<u>(281,571)</u>	<u>(255,019)</u>
<b>Noncapital financing activities</b>		
Proceeds from restricted contributions	160	48
Net ad valorem taxes received	341,113	326,646
Net tobacco settlement received	5,012	4,592
Net cash provided by noncapital financing activities	<u>346,285</u>	<u>331,286</u>
<b>Capital and related financing activities</b>		
Acquisitions and construction of capital assets, net of deletions	(38,092)	(21,983)
Interest paid	(10,477)	(10,762)
Repayment of long-term debt	(6,482)	(5,590)
Net cash used in capital and related financing activities	<u>(55,051)</u>	<u>(38,335)</u>
<b>Investing activities</b>		
Receipts of interest income and realized gains and losses	5,223	11,656
Purchase of investment securities	(300,187)	(247,588)
Proceeds from sale and maturities of investment securities	247,785	203,759
Decrease in assets limited as to use	9,520	2,959
Net cash used in investing activities	<u>(37,659)</u>	<u>(29,214)</u>
Net (decrease) increase in cash and cash equivalents	<u>(27,996)</u>	8,718
Cash and cash equivalents at beginning of year	56,319	47,601
Cash and cash equivalents at end of year	<u>\$ 28,323</u>	<u>\$ 56,319</u>
<b>Schedule of noncash capital and related financing activities</b>		
Assets acquired through capital lease	\$ —	\$ (2,830)

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

Combined Statements of Cash Flows (continued)

	<b>Year ended</b>	
	<b>February 29</b>	<b>February 28</b>
	<b>2004</b>	<b>2003</b>
	<i>(In Thousands)</i>	
Reconciliation of operating loss to net cash used in operating activities:		
Operating loss	<b>\$ (318,421)</b>	\$ (269,591)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Interest expense on capital financing	<b>10,179</b>	10,482
Depreciation and amortization expense	<b>28,890</b>	25,433
Changes in operating assets and liabilities:		
Increase in accounts receivable	<b>(10,497)</b>	(965)
Increase in inventories	<b>(1,886)</b>	(520)
Increase in prepaid expenses and other assets	<b>(14,216)</b>	(17,033)
Decrease in net pension asset	<b>2,517</b>	186
Decrease in accounts payable and accrued liabilities	<b>(2,056)</b>	(8,736)
Increase (decrease) in employee compensation and related benefit liabilities	<b>17,090</b>	(4,943)
Increase in compensated absences	<b>1,503</b>	1,094
Increase in medical claims liability	<b>1,426</b>	11,061
Increase (decrease) in estimated third-party payor settlements	<b>3,900</b>	(1,487)
	<b>36,850</b>	14,572
Net cash used in operating activities	<b>\$ (281,571)</b>	\$ (255,019)

*See accompanying notes.*

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

Notes to Combined Financial Statements

February 29, 2004

**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 and a hospital-based skilled nursing and rehabilitation facility and psychiatric unit, with a total of 979 licensed beds. The District also operates 11 health clinics, 2 specialty clinics providing dental and HIV/AIDS treatment services, and 8 school-based or mobile 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”), a blended component unit of the District, is a Texas not-for-profit corporation incorporated on May 8, 1996, and organized under Section 501c(4) of the Internal Revenue Code to operate as a health maintenance organization. The HMO was licensed by the Texas Department of Insurance on February 14, 1997. As of February 29, 2004, the HMO had approximately 49,300 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.

In accordance with 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*, the District's financial statements include a statement of net assets, a statement of revenue, expenses, and change in net assets, and a statement of cash flows.

The statement of net assets requires that total net assets be reported in three components: (a) invested in capital assets, net of related debt, (b) restricted, and (c) 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."

**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. All significant intra-entity accounts and transactions have been eliminated.

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)**

**Significant Accounting Pronouncements**

GASB Statement No. 39, *Determining Whether Certain Organizations Are Component Units*, is effective for the District on March 1, 2004. The effect of the adoption is not expected to result in a change to the financial statements of the District.

**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.

Investments are classified (as defined by the GASB) in three categories to give an indication of the level of risk assumed by the entity at year-end. Category 1 includes investments that are insured or registered or for which the securities are held by the District or its agent in the District's name. Category 2 includes uninsured and unregistered investments for which the securities are held by the broker's or dealer's trust department or agent in the District's name. Category 3 includes uninsured and unregistered investments for which the securities are held by the broker or dealer or by its trust department or agent but not in the District's name. Investments at February 29, 2004 and February 28, 2003, are primarily classified as Category 1 and are reported at fair value, with realized and unrealized gains and losses included in investment income in the statements of revenues, expenses, and changes in net assets.

**Inventories**

Inventories are valued at the lower of cost, using the first-in, first-out method, or market and consist principally of 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 that substantially increase the useful life of existing property, plant, and equipment. Ordinary maintenance and repairs are charged to expense when incurred.

Disposals are removed at carrying cost less accumulated depreciation, with any resulting gain or loss included in other nonoperating revenue or expense. Depreciation is recorded on the straight-line method over the estimated useful lives of the assets. Estimated useful lives for buildings are up to 40 years and for equipment are 2 to 25 years. Equipment under capital lease is amortized on the straight-line method over the lesser of the useful life of the equipment or the lease term. Such amortization is included in depreciation and amortization in the accompanying combined statements of revenues, expenses, and changes in net 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 that expense to restricted net assets to the extent such are available and then to unrestricted net assets.

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)**

**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.

**Charity Care Policy**

The District accepts all Harris County 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 and place of primary residence.

**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. Supplemental delivery premiums received for Medicaid-eligible births are recognized based on claims information from Texas hospitals and the state and include estimates for incurred but unreported births at year-end.

**Medical Claims Expense**

The HMO arranges for comprehensive health care services to its members primarily through fee-for-service arrangements. Certain services, however, are arranged through capitation, a fixed, monthly payment made without regard to the frequency, extent, or nature of the health care services actually furnished. Under capitation 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.

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)**

Medical claims expense reserves represent the estimated ultimate net cost of all reported and unreported losses incurred through February 29. The reserves for unpaid medical claims expenses are actuarially estimated based on claims experience and statistical analyses. Those estimates are subject to the effects of trends in loss severity and frequency. Although considerable variability is inherent in such estimates, management believes the reserves for medical claims expenses are adequate. The estimates are continually reviewed and adjusted as necessary as experience develops or new information becomes known; such adjustments are included in current operations.

Changes in the HMO's aggregate liability for medical claims in fiscal years 2004 and 2003 were as follows:

Year ended February 29/28	Beginning of Fiscal Year Liability	Current-Year Claims and Changes in Estimates	Claim Payments	End of Fiscal Year Liability
<i>(In Thousands)</i>				
2004	\$ 16,789	\$ 90,168	\$ 88,742	\$ 18,215
2003	5,728	57,284	46,223	16,789

**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.

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)**

**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 \$5,012,000 associated with the settlement in fiscal year 2004. Settlement revenues for fiscal year 2005 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.

**Capital Contributions**

Contributions, grants, and other revenue restricted by donors for specific purposes are recorded in a restricted asset fund. Each fund has an administrator responsible for monitoring revenues and expenses and ensuring funds are being used for the stated purpose. To the extent qualifying expenditures are incurred, restricted assets are generally recognized as additions to unrestricted assets.

**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 revenues and expenses during the reported period. Actual results could differ from those estimates.

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

Notes to Combined Financial Statements (continued)

**3. Net Patient Service Revenue**

Net patient service revenue is composed of the following:

	<b>Year ended</b>	
	<b>February 29 2004</b>	<b>February 28 2003</b>
	<i>(In Thousands)</i>	
Gross patient service revenue, net of charity care provided	<b>\$ 629,914</b>	\$ 559,723
Deductions from revenue:		
Contractual allowance:		
Medicare	<b>57,779</b>	46,126
Medicaid	<b>117,849</b>	85,107
Managed Medicaid	<b>28,700</b>	30,187
Provision for bad debt expense	<b>170,695</b>	162,529
Other discounts	<b>14,033</b>	15,457
Net patient service revenue	<b>\$ 240,858</b>	\$ 220,317

Charity care provided during the years ended February 29, 2004 and February 28, 2003, measured at established rates, totaled \$505,897,000 and \$391,930,000, 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. Medicare outpatient services are reimbursed on fee schedules and 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, 2002.

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)**

**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% of the District's total cash collections for patient service revenues for the years ended February 29, 2004 and February 28, 2003. Cash received from the Medicaid program (including managed Medicaid) accounted for approximately 56% of the District's total cash collections for patient service revenues for the years ended February 29, 2004 and February 28, 2003.

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.

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

Notes to Combined Financial Statements (continued)

**4. Disproportionate Share III and Upper Payment Limit Programs**

The Disproportionate Share III (“DSH”) program 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. According to the DSH program 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 (“UPL”) program was created in May 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.

The District recognizes all funds received under the DSH and UPL programs as operating revenues in the period applicable to the receipt of the funds. Any amounts related to that year that are not received as of fiscal year-end are recorded as receivables and reflected in other current assets in the accompanying combined statements of net assets. These receivables can be subject to adjustments which are reflected in the period they become known. The District has recorded a \$28.7 million and \$15.5 million receivable at February 29, 2004 and February 28, 2003, respectively, related to the DSH and UPL programs.

**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 bond issues (50% 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, and commercial paper approximates fair value.

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

Notes to Combined Financial Statements (continued)

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

The fair value of government securities is based on quoted market prices as of February 29, 2004 and February 28, 2003. The following table sets forth the components of assets limited as to use at fair value at February 29, 2004:

<b>Description of Assets</b>	<b>Total</b>	<b>Debt Service</b>	<b>Other</b>
	<i>(In Thousands)</i>		
Cash and time deposits	\$ 40	\$ 27	\$ 13
Government securities	79,170	78,115	1,055
	79,210	78,142	1,068
Less funds required for current liabilities	(6,881)	(6,881)	-
	<u>\$ 72,329</u>	<u>\$ 71,261</u>	<u>\$ 1,068</u>

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	-
	88,730	87,822	908
Less funds required for current liabilities	(6,425)	(6,425)	-
	<u>\$ 82,305</u>	<u>\$ 81,397</u>	<u>\$ 908</u>

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 29, 2004:

	<b>Beginning Balance</b>	<b>Additions/ Transfers</b>	<b>Retirements</b>	<b>Ending Balance</b>
	<i>(In Thousands)</i>			
Land and land improvements	\$ 11,881	\$ 230	\$ (293)	\$ 11,818
Building and improvements	252,835	4,716	(1,425)	256,126
Equipment	148,748	29,617	(16,782)	161,583
Total at historical cost	413,464	34,563	(18,500)	429,527
Less accumulated depreciation	(236,237)	(27,847)	14,533	(249,551)
Construction in progress	1,202	3,816	(85)	4,933
Property, plant, and equipment, net	\$ 178,429	\$ 10,532	\$ (4,052)	\$ 184,909

**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

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

Notes to Combined Financial Statements (continued)

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

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 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 \$3,982,000 at February 29, 2004. 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 the combined statements of net assets at February 29, 2004. Principal amounts of total defeased indebtedness outstanding at February 29, 2004, are \$38,159,000. The fair market value of the 1990 Bonds and 2000 Bonds outstanding at February 29, 2004, based on quoted market prices, is approximately \$174,350,000.

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

Long-term debt maturities and capital lease obligations are as follows:

	<b>Long-Term Debt</b>	<b>Capital Lease Obligations</b>
	<i>(In Thousands)</i>	
2005	\$ 6,485	\$ 483
2006	6,965	559
2007	7,490	598
2008	8,055	639
2009	8,655	79
Thereafter	110,960	—
Total	148,610	2,358
Less: Unamortized discount on Series 1990 revenue bonds	(387)	—
Unamortized premium and deferred loss on refunding on Series 2000 revenue bonds	(1,505)	—
Total	\$ 146,718	\$ 2,358

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

Notes to Combined Financial Statements (continued)

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

**Notes Payable**

In January 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 Bank of America, N.A. At February 29, 2004, notes outstanding were \$24,251,000.

**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, trusteed 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 (a) 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 (b) 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**

Prior to 2004, the contribution requirements for the District's fiscal year were based on the actuarial valuation as of 14 months before the beginning of that fiscal year. In 2004, the contribution determination was changed and based on an actuarial valuation as of two months before the beginning of the fiscal period. The valuation date to determine the contribution for the fiscal year ending February 29, 2004, was changed from January 1, 2002, to January 1, 2003. This had the effect of recognizing actuarial gains or losses on a more timely basis. This change increased the recommended contribution from \$9,030,571 to \$16,517,558 for the fiscal year ending February 29, 2004.

<b>Fiscal Year Ending</b>	<b>Annual Pension Cost (APC)</b>	<b>Percentage of APC Contributed</b>	<b>Net Pension (Asset) Obligation</b>
02/29/04	\$ 16,691,291	0.00%	\$ 14,174,502
02/28/03	\$ 3,311,708	94.39%	\$ (2,516,789)
02/28/02	\$ 3,934,353	94.91%	\$ (2,703,404)

The plan is on a calendar year-end, and the actuarially determined contribution requirement intended to cover normal cost was approximately \$16,518,000 (8.9% of January 1, 2003, covered payroll) and \$3,126,000 (1.9% of January 1, 2002, covered payroll) for the years ended December 31, 2003 and 2002, respectively.

There were no contributions made during the year ended February 29, 2004. The District subsequently made a \$9,031,000 contribution in March 2004. Pension expense recognized in the combined statements of revenue, expenses, and changes in net assets was \$16,691,291 and \$3,512,970 for the years ended February 29, 2004 and February 28, 2003, respectively.

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

Notes to Combined Financial Statements (continued)

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

**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 29, 2004 and February 28, 2003, those costs were approximately \$5,565,000 and \$4,731,000, respectively. The number of retirees and beneficiaries eligible to receive the benefits was 1,611 at January 1, 2003.

**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. 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 \$12,000 and \$11,000 during calendar years 2004 and 2003, respectively, for participants under the age of 50. Contributions to the plan cannot exceed the statutory maximum of \$14,000 during calendar year 2003 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, 2003 and 2002, were \$9,361,000 and \$8,657,000, 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

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

Notes to Combined Financial Statements (continued)

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

District's property until paid or made available to participants. The plan assets at February 29, 2004 and February 28, 2003, were approximately \$19,782,000 and \$14,532,000, respectively. A corresponding liability to the participants of an equal amount exists at February 29, 2004 and February 28, 2003.

**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 29, 2004 and February 28, 2003, is as follows:

	<b>2004</b>	<b>2003</b>
Medicaid	<b>59%</b>	57%
Medicare	<b>12</b>	15
Commercial and self-pay patients	<b>29</b>	28
	<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 29, 2004, 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.

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

Notes to Combined Financial Statements (continued)

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

At February 29, 2004, the District had commitments outstanding in the amount of approximately \$1,543,000 related to improvements at existing facilities.

The District had rental expenses related to its operating leases of approximately \$4,341,000 and \$4,241,000 during the years ended February 29, 2004 and February 28, 2003, respectively.

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 4% 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>
2003	\$ 7,856	\$ 5,163	\$ 4,063	\$ 8,956
2002	8,160	2,975	3,279	7,856

The District has recorded liabilities related to workers' compensation of approximately \$9,675,000 and \$8,471,000 at February 29, 2004 and February 28, 2003, respectively. These liabilities are included in accounts payable and accrued liabilities in the accompanying combined 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, 2003

<b>Valuation Date</b>	<b>Actuarial Value of Assets (AVA)</b>	<b>Actuarial Accrued Liability (AAL)</b>	<b>Overfunded (Unfunded) 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, 2003	\$ 274,689	\$ 311,411	\$ (36,722)	88.2%	\$ 184,799

Note 1: Dollar amounts in thousands.

Note 2: All required supplementary information has been prepared in accordance with Governmental Accounting Board Statement Nos. 25 and 27 (“GASB Nos. 25 and 27”), *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contributions Plans*, respectively.

Note 3: Applicable actuarial valuation “as-of date” changed from 14 months prior to the beginning of the fiscal year to two months prior to the beginning of the fiscal year effective for the fiscal year ending February 29, 2004. This eliminated the need for a January 1, 2002, valuation.

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

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, 2003
Actuarial cost method	Projected unit credit
Amortization method	Level dollar, open
Amortization period	Ten years
Asset valuation method	Three-year smoothed market
Actuarial assumptions:	
Inflation	3.50%
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