Harris County Hospital District,
d/b/a Harris Health System,
A Component Unit of Harris County, Texas

Independent Auditor's Report and Financial Statements

February 28, 2018 and 2017

BKD LLP
CPAs & Advisors

Harris County Hospital District, d/b/a Harris Health System, A Component Unit of Harris County, Texas

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Contents

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Independent Auditors' Report

Board of Trustees
Harris County Hospital District,
d/b/a Harris Health System
Houston, Texas

Report on the Financial Statements

We have audited the accompanying financial statements of the business-type activities and the aggregate discretely presented component units of Harris County Hospital District, d/b/a Harris Health System (the System), collectively a component unit of Harris County, Texas, as of and for the year ended February 28, 2018, and the related notes to the financial statements, which collectively comprise the System's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the Harris County Hospital District Foundation (Foundation), a discretely presented component unit of the System, which represent 9.0 percent of total assets, 25.8 percent of net position and 0.2 percent of the revenues of the aggregate discretely presented component units for the year then ended. Those statements were audited by other auditors, whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for the Foundation is based solely on the report of the other auditors. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement. The financial statements of the discretely presented component units, which are included in the System's financial statements, were not audited in accordance with *Government Auditing Standards*.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error

In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinions

In our opinion, based on our audit and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities and the discretely presented component units of the System as of February 28, 2018, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Prior Year Audited by Other Auditors

The 2017 financial statements were audited by other auditors and their report thereon, dated June 29, 2017, expressed an unmodified opinion.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis, pension and other postemployment benefit information, as listed in the table of contents, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context.

We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards,* we have also issued our report dated June 28, 2018, on our consideration of the System's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the System's internal control over financial reporting and compliance.

BKD, LLP

Houston, Texas
June 28, 2018

Harris County Hospital District, d/b/a Harris Health System, A Component Unit of Harris County, Texas

Management's Discussion and Analysis (Unaudited)

February 28, 2018 and 2017

This section of the Harris Health System's (the System) financial report presents background information and management's analysis of the System's financial results for the fiscal years ended February 28, 2018 and 2017. This section should be read in conjunction with the System's financial statements, which begin on page 13.

Financial Highlights

- The System's net position decreased approximately $22 million (4.2 percent) in fiscal 2018 and increased $24 million (4.7 percent) in fiscal 2017. In December 2017, the System contributed $60 million to Community Health Choice, Inc., to provide additional risk-based capital for the calendar year ending December 31, 2017.

- No changes were made to the System's debt structure in fiscal 2018. In the second quarter of fiscal 2017, the System issued $62.8 million Combination Tax and Revenue Certificates of Obligation to fund improvements at Ben Taub Hospital in order to maintain the hospital's Level 1 trauma status.

- For fiscal years 2018 and 2017, the System's tax rate was increased to fund debt service requirements for the Series 2016 Certificates of Obligation. In addition, the tax base increased approximately 4.0 percent and 8.5 percent in fiscal 2018 and fiscal 2017 respectively.

- Total assets and deferred outflows decreased approximately $10 million (0.7 percent) between fiscal 2017 and fiscal 2018 and increased approximately $107 million (7.5 percent) between fiscal 2016 and fiscal 2017. The fiscal 2018 decrease was due to the transfer of $60 million to Community Health Choice, Inc. The fiscal 2017 increase was due to increased investments as a result of the funds available from the debt issuance and increased ad valorem taxes.

- Long-term debt, including current portion, decreased approximately $10 million (3.0 percent) in fiscal 2018 and increased approximately $60 million (21.8 percent) in fiscal 2017 as a result of the 2016 Certificates of Obligation. Other liabilities decreased approximately $2 million (0.3 percent) in fiscal 2018 and increased approximately $20 million (3.1 percent) in fiscal 2017.

- The Community Health Choice HMOs (Community Health Choice Texas, Inc. - the Medicaid Managed Care HMO and Community Health Choice, Inc. - the Health Insurance Marketplace and commercial HMO) experienced a 17.8 percent growth in membership during fiscal 2018 and 21.7 percent growth in membership during fiscal 2017.

- The number of unduplicated patients served by the System decreased 3.3 percent and 2.2 percent in fiscal 2018 and 2017, respectively. Services provided on an inpatient basis decreased 6.1 percent and 6.8 percent in fiscal 2018 and 2017, respectively. Emergency care/urgent visits decreased 2.3 percent in fiscal 2018 and 4.1 percent in fiscal 2017.

- The Centers for Medicare and Medicaid Services (CMS) approved a five-year renewal of the Section 1115 Waiver for the Texas Medicaid program in December 2017. The renewal period runs through September 30, 2022.

- During fiscal 2018 and 2017, the System invested $70 million and $45 million, respectively, in space/facility expansion projects, critical information technology and medical equipment. Significant capital acquisitions and resource investments included the following:

    - Semi-private room renovations at the Ben Taub campus and the LBJ campus are near completion. Operational beds decreased approximately 1.7 percent in fiscal 2018 and 4.0 percent in fiscal 2017.

    - Expansion of operating suites and supporting services to maintain Level I trauma services at Ben Taub Hospital is on-going. Construction, funded by the 2016 bond issue, is expected to be completed in early calendar 2019.

Financial Statements

The System's financial statements are prepared on the accrual basis of accounting and present the System's operational activities in a manner similar to that of private sector companies. The financial statements consist of three statements: (1) statements of net position, (2) statements of revenues, expenses and changes in net position, and (3) statements of cash flow. The statements provide information about the activities of the System, the Harris County Hospital District Foundation (the Foundation), and the Community Health Choice HMOs, which are reported as discretely presented component units. The statements of net position and the statements of revenues, expenses and changes in net position reflect the System's financial position at the end of the fiscal year and report the net position and changes as a result of the revenues and expenses for the year. The statement of net position presents the assets, deferred outflows, liabilities, deferred inflows and net position of the System at the end of the year. The net position section presents assets plus deferred outflows of resources, less liabilities, less deferred inflows of resources. Increases or decreases in net position 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 System'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 noncapital/capital financing activities. The statement explains where cash came from, how it was used and the change in cash balance during the year.

Net Position

Table 1
Condensed Statements of Net Position
(In millions)

	2018	2017	Dollar Change	Total Percentage Change	2016	Dollar Change	Total Percentage Change
Assets							
Current and other assets	$ 1,066	$ 1,057	$ 9	0.9%	$ 924	$ 133	14.4%
Capital assets	436	422	14	3.3%	431	(9)	-2.1%
Total assets	1,502	1,479	23	1.6%	1,355	124	9.2%
Deferred outflows of resources:							
Derivative financial instrument	6	9	(3)	-33.3%	19	(10)	-52.6%
Resources related to pension	8	36	(28)	-77.8%	43	(7)	-16.3%
Unamortized loss on refunding debt	10	12	(2)	-16.7%	12	-	0.0%
Total deferred outflows	24	57	(33)	-57.9%	74	(17)	-23.0%
Total assets and deferred outflows	$ 1,526	$ 1,536	$ (10)	-0.7%	$ 1,429	$ 107	7.5%
Liabilities							
Long-term debt outstanding	$ 325	$ 335	$ (10)	-3.0%	$ 275	$ 60	21.8%
Other liabilities	666	668	(2)	-0.3%	648	20	3.1%
Total liabilities	991	1,003	(12)	-1.2%	923	80	8.7%
Deferred inflows of resources:							
Resources related to pension	27	3	24	800.0%	-	3	0.0%
Total deferred inflows	27	3	24	800.0%	-	3	0.0%
Total liabilities and deferred inflows	$ 1,018	$ 1,006	$ 12	1.2%	$ 923	$ 83	9.0%
Net investment in capital assets	$ 164	$ 148	$ 16	10.8%	$ 155	$ (7)	-4.5%
Restricted	32	24	8	33.3%	32	(8)	-25.0%
Unrestricted	312	358	(46)	-12.8%	319	39	12.2%
Total net position	$ 508	$ 530	$ (22)	-4.2%	$ 506	$ 24	4.7%

Total net position represents the residual interest in the System's assets and deferred outflows after liabilities and deferred inflows are deducted. As stated previously, net position decreased $22 million (4.2 percent) and increased $24 million (4.7 percent) in fiscal 2018 and 2017, respectively. The overall decrease in fiscal 2018 is the result of a $60 million contribution to Community Health Choice Inc., to provide additional risk-based capital. The overall increase in fiscal 2017 is a result of the gain reported for the year primarily from the increase in ad valorem tax revenue.

Total assets and deferred outflows of resources decreased 0.7 percent from fiscal 2017 to 2018 and increased 7.5 percent from fiscal 2016 to 2017.

- Current and other assets increased 0.9 percent from fiscal 2017 to fiscal 2018 and 14.4 percent from fiscal 2016 to fiscal 2017. Investment of funds from increased revenues generated by the Medicaid supplemental programs and continuing strong ad valorem tax collections resulted in the fiscal 2018 increase. Investment of the funds from the issuance of debt and increased ad valorem tax collections generated the increase in 2017.
- Capital assets are discussed in detail following Table 3.
- Deferred outflows of resources consist of the fair market value of derivatives, unamortized losses on refunding of debt and resources related to the System's pension plan. Deferred outflows related to pension decreased $28 million in fiscal 2018 and $7 million in fiscal 2017. Deferred outflows related to hedging derivatives decreased $3 million in fiscal 2018 and $10 million in fiscal 2017, respectively, with an offsetting change in derivative liability.

Total liabilities and deferred inflows of resources increased $12 million (1.2 percent) and increased $83 million (9.0 percent) in fiscal 2018 and 2017, respectively.

- In 2018, reductions in bond-related debt reflect scheduled debt service payments. In fiscal 2017, long term debt increased $60 million, the net effect of scheduled debt service payments, issuance of Series 2016 Certificates of Obligation and the refunding of the 2007A Refunding Revenue Bonds with the Series 2016 Refunding Revenue Bonds.
- Other liabilities decreased $2 million or 0.3 percent in fiscal 2018 and increased $20 million or 3.1 percent in fiscal 2017.
- The System's net obligation for the provision of certain postemployment healthcare benefits increased approximately $41 million in fiscal 2018 and $33 million in fiscal 2017.
- Obligations under the Harris Collaborative Program increased $26.8 million as of February 28, 2018, resulting in a $3.8 million liability. These obligations were $45.4 million less at February 28, 2017 than February 29, 2016 resulting in a $23.0 million advance toward the Program's 2017 fiscal year.
- Deferred inflows of resources related to pension increased $24 million in fiscal 2018 and $3 million in fiscal 2017.
- The reported derivative liability associated with an interest rate swap decreased $3 million in fiscal 2018 and $9.6 million at February 28, 2017 as compared to February 29, 2016.

In December 2017, Texas received federal approval to renew the 1115 Waiver. As of February 28, 2018, the System recorded liabilities of $14 million related to advance payments received under the 2018 Disproportionate Share, Uncompensated Care Pool, and Delivery System Reform Incentive Payment Pool estimated programs. Related revenues recorded in fiscal 2018 included $1.8 million favorable prior year program adjustments. The System had recorded receivables of $3.7 million at February 28, 2018, related to these Medicaid supplemental programs. Medicaid supplemental programs revenue recorded in fiscal 2017 included a favorable adjustment of $2.8 million for prior years' programs. As of February 28, 2017, the System recorded liabilities of $14.0 million related to advance payments received under the 2017 estimated program.

The System also participates in the NAIP (Network Access Improvement Program) and UHRIP (Uniform Hospital Rate Increase Program) Medicaid supplemental programs. Total assets related to these programs total $18.4 million and $1.9 million at February 28, 2018 and 2017, respectively.

Summary of Revenues, Expenses and Changes in Net Position

The following table summarizes the System's revenues and expenses for each of the years ended February 28, 2018, February 28, 2017 and February 29, 2016, and the changes in net position during each of those years.

Table 2
Condensed Summary of Revenues, Expenses and Changes in Net Position
(In thousands)

	2018	2017	2016
Operating Revenues			
Net patient service revenue	$ 402,551	$ 390,180	$ 361,523
Medicaid supplemental programs revenues	266,468	230,279	263,106
Other operating revenues	27,143	29,508	28,066
Total operating revenues	696,162	649,967	652,695
Operating Expenses			
Salaries, wages and benefits	756,589	729,721	699,514
Purchased services, supplies and other	574,661	538,991	529,639
Depreciation and amortization	53,963	54,275	56,885
Total operating expenses	1,385,213	1,322,987	1,286,038
Operating Loss	$ (689,051)	$ (673,020)	$ (633,343)
Nonoperating Revenues			
Ad valorem tax revenues - net	$ 717,017	$ 698,819	$ 635,363
Tobacco settlement revenues	13,424	7,847	10,944
Investment income	7,815	5,273	2,151
Other	(453)	539	468
Total nonoperating revenues	737,803	712,478	648,926
Nonoperating Expenses			
Interest expense	(11,280)	(14,956)	(14,536)
Contribution to HMO	(60,000)	-	-
Total nonoperating expenses	(71,280)	(14,956)	(14,536)
Income (Loss) Before Other Revenues, Expenses, Gains, Losses and Transfers	(22,528)	24,502	1,047
Capital contributions	169	-	-
Change in net position	(22,359)	24,502	1,047
Net Position - Beginning of Year, as Previously Stated	530,294	505,792	703,096
Prior period adjustment	-	-	(198,351)
Net Position - Beginning of Year, as Restated	530,294	505,792	504,745
Net Position - End of Year	$ 507,935	$ 530,294	$ 505,792

Revenues

Operating revenues increased $46.2 million (7.1 percent) during the fiscal year ended February 28, 2018. During the year ended February 28, 2017, the System's total operating revenue decreased $2.7 million (0.4 percent).

- Net patient service revenue increased $12.4 million in fiscal 2018 and $28.7 million in fiscal 2017.
- Estimated revenues from Medicaid supplemental programs increased $36.2 million and decreased $32.8 million in fiscal 2018 and 2017, respectively.
- Other operating revenues decreased $2.4 million in fiscal 2018 and increased $1.4 million in fiscal 2017 as compared to fiscal 2016.

Operating Expenses

During the year ended February 28, 2018, total operating expenses increased $62.2 million (4.7 percent).

- System salaries and wages increased $21.7 million (4.2 percent) as a result of increases in staffing, approximately 1.1 percent, and an average wage increase of 3.1 percent.
- Related benefits increased $5.2 million (2.5 percent) due to increases in employee medical plan costs.
- Purchased medical services, supplies, and other operating expenses increased $35.7 million (6.6 percent), primarily as a result of increased costs for physician services, $21.3 million (9.8 percent), and remediation work related to water intrusion during Hurricane Harvey.

During the year ended February 28, 2017, total operating expenses increased $36.9 million (2.9 percent).

- System salaries and wages increased $9.7 million (1.9 percent) as a result of increases in staffing, approximately 0.3 percent, and an average wage increase of 1.9 percent.
- Related benefits increased $20.5 million (10.8 percent) due to increases in employee medical plan costs, post-employment health benefits, and pension plan costs.
- Purchased medical services, supplies, and other operating expenses increased 1.8 percent, primarily as a result of increased costs for physician services.

Overall, the System's operating loss increased 2.4 percent from 2017 to 2018 and increased 6.3 percent from 2016 to 2017 as a result of the items discussed above. The System 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 and expenses consist of revenues and expenses related to financing and investing types of activities, including grants and donations for activities not considered as operating activities, and include property tax revenue, investment income, tobacco settlement funds, interest expense, contribution to HMO, gains or losses on disposal of assets, and certain grants and donations. Tax revenues, net of related expenses, increased $18.2 million, or 2.6 percent, in fiscal 2018 and $63.5 million, or 10.0 percent, in fiscal 2017.

Investment income increased $2.5 million in fiscal 2018 and $3.1 million in fiscal 2017. The System received approximately $13.4 million and $7.8 million in tobacco settlement revenue in fiscal year 2018 and 2017, respectively. Interest expense decreased approximately $3.7 million in fiscal 2018 subsequent to the issuance of the refunding revenue bonds in fiscal 2017. The System contributed $60 million to Community Health Choice, Inc. to provide additional risk-based capital for the calendar year ended December 31, 2017.

Capital Assets and Debt Financing

During fiscal 2018 and 2017, the System invested $70 million and $45 million, respectively, in information technology, equipment, and facility expansion and renovation. Table 3 summarizes the changes in the System's capital assets between February 28, 2018 and February 29, 2016:

Table 3
Changes in Capital Assets
(In thousands)

	2018	2017	Dollar change	Total percentage change	2016	Dollar change	Total percentage change
Land and improvements	$ 43,096	$ 42,012	$ 1,084	2.6%	$ 41,792	$ 220	0.5%
Buildings and fixed equipment	641,490	616,643	24,847	4.0%	606,667	9,976	1.6%
Major movable equipment	365,114	351,041	14,073	4.0%	338,486	12,555	3.7%
Subtotal	1,049,700	1,009,696	40,004	4.0%	986,945	22,751	2.3%
Less accumulated depreciation	(647,193)	(613,999)	(33,194)	5.4%	(575,483)	(38,516)	6.7%
Construction in progress	33,459	26,312	7,147	27.2%	20,015	6,297	31.5%
Capital assets - net	$ 435,966	$ 422,009	$ 13,957	3.3%	$ 431,477	$ (9,468)	-2.2%

Annually, the System conducts an assessment of its facilities, equipment and technology to determine the priorities for replacement, repair and any new acquisitions. The assessment and prioritization process addresses obsolescence, new technology, building safety and code compliance requirements. As a result, the System's capital plan for fiscal year 2019 includes an investment of $77.5 million in routine capital expenditures. The capital projects include $20.9 million in information technology primarily dedicated to current system upgrades and technology refresh, $23.5 million specific to medical capital, and $33.1 million in renovations of current facilities.

Not included in the budget discussion above is the Ben Taub Trauma Center project. Ben Taub's trauma center is one of only two Level 1 trauma centers in Houston. To ensure Ben Taub's trauma center retains its Level 1 status, steps are being taken to address sufficient operating room availability and trauma surgeon staffing. The $62.8 million in Certificates of Obligation were issued in August 2016 to fund the necessary expansion of operative suites and supporting services. Construction is underway and expected to be completed in 2019.

At February 28, 2018 and 2017, the System had $244.7 million and $250.3 million, respectively, in outstanding revenue bonds. Moody's and Standard and Poor's have an underlying rating of A2/A on the revenue bond obligations. The debt is scheduled to be repaid in 2042. The debt is issued in the name of the Harris County Hospital District. Any issuance of debt requires the approval of the System's Board of Trustees and the Harris County Commissioners' Court.

An interest rate swap and derivative liability are associated with the Series 2010 refunding and revenue bonds. The fair value of the interest rate swap was reported as a derivative liability of $6.4 million and $9.4 million at February 28, 2018 and 2017, respectively. An off-market element associated with the swap is reported as a borrowing payable in the amount of $11.1 million and $11.9 million at February 28, 2018 and 2017, respectively.

Table 4 below summarizes the System's debt obligations at February 28, 2018, February 28, 2017, and February 29, 2016:

Table 4
Long-term Debt Obligations
(In thousands)

	2018	2017	2016
Series 2007 revenue bonds	$ -	$ -	$ 181,320
Series 2010 revenue bonds	89,595	91,790	93,925
Series 2016 revenue bonds	169,176	173,639	-
Series 2016 certificates of obligation	66,389	69,166	-
Borrowing payable - interest rate swap	11,139	11,932	12,742
Derivative liability	6,437	9,388	18,949
Other long-term obligations	288	187	246
Total long-term debt and other long-term obligations	343,024	356,102	307,182
Less current portion	(8,180)	(7,817)	(5,686)
Noncurrent portion	$ 334,844	$ 348,285	$ 301,496

The System's long-term debt and short-term debt ratings at February 28, 2018 and 2017 were "AA" and "F1."

Economic Conditions and Plan for Fiscal 2019

In planning for fiscal 2019, the primary concerns were the same as prior year – the uncertain status of the economy at both the federal and state funding levels and the uncertainty of federal healthcare reform efforts and their potential financial and operational impact on the System. While the healthcare environment at the national and state levels is still uncertain, we do not expect any significant changes occurring within the next year that would impact current operations. Assumptions and issues that will need to be monitored on an ongoing basis include:

- The number of individuals receiving patient care from our System will remain stable for fiscal 2019
- Continuing demand for services by the uninsured population, coupled with the inflationary pressures, will continue to challenge the capacity of the System at both a physical plant capacity level and staffing availability level
- Increased cost of maintaining existing services will be mitigated by efforts to reduce expenses and increase efficiency and productivity

- Property tax funding will be relatively flat reflecting a small net increase in the valuation of properties within Harris County, after netting lost property values due to Hurricane Harvey and subsequent flooding
- Timely progress on the Ben Taub Trauma Center project for maintenance of Level I certification
- Stable funding available under the Medicaid Supplemental programs for the upcoming year
- Routine plant and equipment needs for replacement of aged equipment and needed repairs, maintenance, and renovation
- Advancement in the System's key strategic priorities of:
    - Meeting community needs through improved access to care
    - Providing high-quality healthcare
    - Maintenance of financial strength and stable cash positions
    - Positioning the System to succeed in an evolving healthcare reform environment

Contacting the System's Financial Management

This financial report is designed to provide taxpayers, creditors and patients with a general overview of the Harris Health System's finances and to demonstrate the System's accountability for funds it receives. The report is available at https://www.harrishealth.org. If you have questions about this report or need further financial information, contact the Harris Health System, 2525 Holly Hall, Houston, Texas 77054, Attention: Michael Norby, Executive Vice President and Chief Financial Officer (Michael.Norby@harrishealth.org).

Harris County Hospital District,
d/b/a Harris Health System,
A Component Unit of Harris County, Texas
Statements of Net Position
February 28, 2018 and 2017
(In thousands)

	2018				2017		
		Component Units				Component Units	
Assets and Deferred Outflows of Resources	Harris Health System	Foundation	Community Health Choice, Inc.	Community Health Choice Texas, Inc.	Harris Health System	Foundation	Community Health Choice, Inc.
Current Assets							
Cash and cash equivalents	$ 210,046	$ 263	$ 225,827	$ 51,718	$ 88,172	$ 349	$ 177,452
Short-term investments (Notes 5 and 6)	495,382	-	6,524	15,594	492,598	-	93,079
Accounts receivable – net of allowance for uncollectible accounts of $85,111 and $94,225 (Note 10)	66,412	-	-	-	71,450	-	-
Current portion of ad valorem taxes receivable – net of allowance for uncollectible taxes of $7,309 and $7,059	35,366	-	-	-	31,239	-	-
Inventories	9,939	-	-	-	10,693	-	-
Medicaid supplemental programs receivable	22,080	-	-	-	1,854	-	-
Prepaid expenses and other current assets	11,417	788	29,900	21,490	34,038	603	38,156
Estimated third-party payor settlements	10,328	-	-	-	2,494	-	-
Due from Community Health Choice, Inc.	10,252	-	-	41,256	8,938	-	-
Current portion of assets limited as to use or restricted (Notes 5 and 6)	6,352	-	-	-	6,111	-	-
Total current assets	877,574	1,051	262,251	130,058	747,587	952	308,687
Assets Limited as to Use or Restricted – Net of Current Portion (Notes 5 and 6)							
Debt service	24,751	-	-	-	17,234	-	-
BT level 1 trauma	53,181	-	-	-	60,706	-	-
Cash on deposit with county - project management	59,479	-	-	-	35,361	-	-
Other	813	29,186	3,325	600	819	25,401	-
Total assets limited as to use or restricted – net	138,224	29,186	3,325	600	114,120	25,401	0
Capital Assets (Notes 7 and 11)							
Land and improvements	43,096	-	-	-	42,012	-	-
Buildings and fixed equipment	641,490	-	-	-	616,643	-	-
Major movable equipment	365,114	-	-	-	351,041	-	-
Less accumulated depreciation	(647,193)	-	-	-	(613,999)	-	-
Total depreciable capital assets – net	402,507	0	0	0	395,697	0	0
Construction in progress	33,459	-	-	-	26,312	-	-
Capital assets – net	435,966	0	0	0	422,009	0	0

Harris County Hospital District,
d/b/a Harris Health System,
A Component Unit of Harris County, Texas
Statements of Net Position (Continued)
February 28, 2018 and 2017
(In thousands)

	2018				2017		
		Component Units				Component Units	
Assets and Deferred Outflows of Resources (Continued)	Harris Health System	Foundation	Community Health Choice, Inc.	Community Health Choice Texas, Inc.	Harris Health System	Foundation	Community Health Choice, Inc.
Other Assets							
Ad valorem taxes receivable – net of current portion and allowance for uncollectible taxes of $36,399 and $38,463	$ 428	$ -	$ -	$ -	$ 276	$ -	$ -
Long-term investments (Note 6)	49,902	-	1,535	14,879	194,835	-	-
Other assets	66	10,649	-	-	70	11,045	
Total other assets	50,396	10,649	1,535	14,879	195,181	11,045	0
Deferred Outflows of Resources							
Derivative financial instrument	6,437	-	-	-	9,388	-	-
Resources related to pension	7,641	-	-	-	35,499	-	-
Loss on refunding revenue bonds	10,304	-	-	-	12,192	-	-
Total deferred outflows of resources	24,382	0	0	0	57,079	0	0
Total assets and deferred outflows of resources	$ 1,526,542	$ 40,886	$ 267,111	$ 145,537	$ 1,535,976	$ 37,398	$ 308,687

Harris County Hospital District,
d/b/a Harris Health System,
A Component Unit of Harris County, Texas
Statements of Net Position (Continued)
February 28, 2018 and 2017
(In thousands)

	2018				2017		
		Component Units				Component Units	
Liabilities, Deferred Inflows of Resources and Net Position	Harris Health System	Foundation	Community Health Choice, Inc.	Community Health Choice Texas, Inc.	Harris Health System	Foundation	Community Health Choice, Inc.
Current Liabilities							
Accounts payable and accrued liabilities	$ 69,197	$ 656	$ 29,963	$ 1,575	$ 59,710	$ 8	$ 32,128
Interest payable	545	-	-	-	554	-	-
Employee compensation and related benefit liabilities (Note 11)	30,333	-	-	-	27,866	-	-
Compensated absences	36,753	-	-	-	35,652	-	-
Medicaid supplemental programs payable	14,400				14,049		
Medical claims liability (Note 2)	-	-	67,805	91,098	-	-	111,728
Liabilities related to the Affordable Care Act	-	-	53,889	-	-	-	70,369
Due to Harris Health System	-	-	11,472	-	-	-	9,352
Due to Community Health Choice Texas, Inc.	-	-	41,256	-	-	-	-
Estimated third-party payor settlements	7,056	-	-	-	6,450	-	-
Current portion of long-term debt and capital leases (note 8)	8,180	-	-	-	7,817	-	-
Total current liabilities	166,464	656	204,385	92,673	152,098	8	223,577
Other Long-term Liabilities							
Postemployment health benefit liability (Note 9)	309,838	-	-	-	268,442	-	-
Net pension liability (Note 9)	180,493	-	-	-	234,310	-	-
Borrowing payable (Note 8)	11,139	-	-	-	11,932	-	-
Derivative liability	6,437	-	-	-	9,388	-	-
Other	39	-	-	-	38	-	-
Long-term Debt (Note 8)							
Series 2010 refunding revenue bonds	87,325	-	-	-	89,595	-	-
Series 2016 refunding revenue bonds - including premium of $14,091	165,531	-	-	-	170,169	-	-
Series 2016 certificates of obligation - including premium of $6,899	64,199	-	-	-	67,061	-	-
Other long-term obligations – capital leases	174	-	-	-	102	-	-
Total liabilities	991,639	656	204,385	92,673	1,003,135	8	223,577

Harris County Hospital District,
d/b/a Harris Health System,
A Component Unit of Harris County, Texas

Statements of Net Position (Continued)

February 28, 2018 and 2017
(In thousands)

	2018				2017		
		Component Units				Component Units	
Liabilities, Deferred Inflows of Resources and Net Position (Continued)	Harris Health System	Foundation	Community Health Choice, Inc.	Community Health Choice Texas, Inc.	Harris Health System	Foundation	Community Health Choice, Inc.
Deferred Inflows of Resources							
Resources related to pension	$ 26,968	$ 0	$ 0	$ 0	$ 2,547	$ 0	$ 0
Commitments and Contingencies (Note 11)							
Net Position							
Net investment in capital assets	164,012	-	-	-	148,231	-	-
Restricted for debt service	31,916	-	-	-	24,164	-	-
Restricted – other	-	27,210	3,325	600	-	26,323	-
Unrestricted	312,007	13,020	59,401	52,264	357,899	11,067	85,110
Total net position	507,935	40,230	62,726	52,864	530,294	37,390	85,110
Total liabilities, deferred inflows of resources, and net position	$ 1,526,542	$ 40,886	$ 267,111	$ 145,537	$ 1,535,976	$ 37,398	$ 308,687

Harris County Hospital District,
d/b/a Harris Health System,
A Component Unit of Harris County, Texas
Statements of Revenues, Expenses and Changes in Net Position
Years Ended February 28, 2018 and 2017
(In thousands)

	2018				2017		
		Component Units				Component Units	
	Harris Health System	Foundation	Community Health Choice, Inc.	Community Health Choice Texas, Inc.	Harris Health System	Foundation	Community Health Choice, Inc.
Operating Revenues							
Net patient service revenue (Note 3)	$ 402,551	$ -	$ -	$ -	$ 390,180	$ -	$ -
Medicaid supplemental programs revenue (Note 4)	266,468	-	-	-	230,279	-	-
Premium revenue	-	-	825,055	688,311	-	-	1,125,933
Other operating revenues	27,143	2,672	7,479	14	29,508	1,824	335
Total operating revenues	696,162	2,672	832,534	688,325	649,967	1,824	1,126,268
Operating Expenses							
Salaries, wages, and benefits	756,589	486	35,762	27,192	729,721	491	49,746
Pharmaceuticals and supplies	202,161	14	1,712	1,523	202,684	6	3,506
Physician services (Note 12)	237,178	-	-	-	215,926	-	-
Medical claims expense	-	-	738,664	638,053	-	-	1,029,190
Other purchased services	135,322	4,063	81,225	27,689	120,381	3,263	68,149
Depreciation and amortization	53,963	-	-	-	54,275	-	-
Total operating expenses	1,385,213	4,563	857,363	694,457	1,322,987	3,760	1,150,591
Operating Loss	(689,051)	(1,891)	(24,829)	(6,132)	(673,020)	(1,936)	(24,323)
Nonoperating Revenues (Expenses)							
Ad valorem tax revenues – net	717,017	-	-	-	698,819	-	-
Tobacco settlement revenues	13,424	-	-	-	7,847	-	-
Investment income (loss)	7,815	4,901	1,339	308	5,273	4,994	2,177
Interest expense (Note 8)	(11,280)	-	-	-	(14,956)	-	-
Contribution to HMOs - net	(60,000)	-	45,500	14,500	-	-	-
Other	(453)	(170)	(190)	(16)	539	(200)	(916)
Total nonoperating revenues (expenses) – net	666,523	4,731	46,649	14,792	697,522	4,794	1,261
Capital Contributions	169	0	0	0	0	0	0
Changes in net position	(22,359)	2,840	21,820	8,660	24,502	2,858	(23,062)
Net Position – Beginning of Year	530,294	37,390	85,110	-	505,792	34,532	108,172
Net Position Transfer of Surplus	-	-	(44,204)	44,204	-	-	-
Net Position – End of Year	$ 507,935	$ 40,230	$ 62,726	$ 52,864	$ 530,294	$ 37,390	$ 85,110

See Notes to Financial Statements

Harris County Hospital District,
d/b/a Harris Health System,
A Component Unit of Harris County, Texas

Statements of Cash Flows

Years Ended February 28, 2018 and 2017
(In thousands)

	2018 Harris Health System	2017 Harris Health System
Operating Activities		
Receipts from and on behalf of patients	$ 401,295	$ 383,617
Receipts from Medicaid supplemental programs	246,593	316,280
Receipts from incentive programs and grants	10,954	10,560
Receipts from other revenues	14,977	12,345
Payments to suppliers	(535,102)	(581,555)
Payments to employees and for employee benefits	(713,163)	(691,025)
Net cash used in operating activities	(574,446)	(549,778)
Noncapital Financing Activities		
Contributions – net	526	997
Contribution to HMO	(60,000)	-
Ad valorem taxes – net	708,145	689,623
Tobacco settlement revenues	13,424	7,847
Net cash provided by noncapital financing activities	662,095	698,467
Capital and Related Financing Activities		
Receipt of property taxes for debt service	4,687	6,943
Capital contribution	169	-
Acquisitions and construction of capital assets	(60,518)	(42,076)
Project management - cash on deposit with Harris County	(38,399)	(29,928)
Defeasance of Series 2007A bonds	-	(176,499)
Proceeds from Series 2016 bonds	-	174,474
Proceeds from Series 2016 CO bonds	-	70,761
Interest paid	(13,229)	(16,737)
Repayment of long-term debt	(7,849)	(8,575)
Net cash used in capital and related financing activities	(115,139)	(21,637)
Investing Activities		
Receipts of investment income – including realized gains and losses	7,196	5,547
Increase in cash equivalents included in assets limited as to use or restricted	(7,917)	(6,781)
Purchases of investment securities	(577,574)	(712,138)
Proceeds from sale and maturities of investment securities	727,659	473,232
Net cash provided by (used in) investing activities	149,364	(240,140)
Net Increase (Decrease) in Cash and Cash Equivalents	121,874	(113,088)
Cash and Cash Equivalents - Beginning of Year	88,172	201,260
Cash and Cash Equivalents - End of Year	$ 210,046	$ 88,172

Harris County Hospital District,
d/b/a Harris Health System,
A Component Unit of Harris County, Texas

Statements of Cash Flows (Continued)

Years Ended February 28, 2018 and 2017
(In thousands)

	2018 Harris Health System	2017 Harris Health System
Reconciliation of Operating Loss to Net Cash Used in Operating Activities		
Operating loss	$ (689,051)	$ (673,020)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation and amortization	53,963	54,275
Donation of capital asset	(33)	(374)
Changes in operating assets and liabilities:		
Decrease (increase) in accounts receivable	5,038	(7,614)
Decrease (increase) in inventories	754	(972)
(Increase) decrease in Medicaid supplemental programs receivable	(20,226)	71,952
Decrease (increase) in prepaid expenses and other assets	22,547	(26,213)
Increase in estimated third-party payor settlements	(7,834)	(1,689)
Increase (decrease) in accounts payable and accrued liabilities	16,364	(4,699)
(Decrease) increase in net pension liability	(1,538)	3,070
Increase in employee compensation and related benefit liabilities	2,467	4,501
Increase (decrease) in compensated absences	1,101	(1,598)
Increase (decrease) in estimated third-party payor settlements	606	(120)
Increase in postemployment health benefit liability	41,396	32,723
Total adjustments	114,605	123,242
Net cash used in operating activities	$ (574,446)	$ (549,778)
Supplemental Disclosures of Noncash Operating, Financing and Investing Activities		
Unrealized gain on investments	$ 842	$ 596
Amounts related to acquisition of capital assets in accounts payable and accrued liabilities	12,664	19,310
Amount of interest expense capitalized	1,371	939

Harris County Hospital District, d/b/a Harris Health System, A Component Unit of Harris County, Texas

Notes to Financial Statements
February 28, 2018 and 2017

Note 1: Organization and Mission

Harris County Hospital District, d/b/a Harris Health System, (the System), 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 System 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 System operates two acute care hospitals and a hospital-based skilled nursing and rehabilitation facility and psychiatric unit, with a total of 700 licensed beds. The System also operates 18 primary care health clinics; 5 specialty clinics providing dental, dialysis, HIV/AIDS treatment and outpatient specialty services; 5 school-based clinics, 5 same day clinics, and 5 mobile health clinics. The System is exempt from federal income taxes.

The System is a component unit of Harris County, Texas (legally separate from Harris County, Texas) since the members of the System's governing board are appointed by the Harris County Commissioners' Court. The Harris County Commissioners' Court approves the System's tax rate and annual operating and capital budget. Harris County, Texas does not provide any funding to the System, hold title to any of the System's assets or have any rights to any surpluses of the System.

The System'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 System are directly associated with the furtherance of this mission and are, therefore, considered to be operating activities.

The Harris County Hospital District Foundation (the Foundation), was organized in 1993. The Foundation is a nonprofit, tax-exempt corporation organized under Section 501 (c)(3) of the Internal Revenue Code whose primary purpose is to raise funds to support the operations and activities of the System. Although the System does not control the timing or amount of receipts from the Foundation, the majority of resources (or income thereon) that the Foundation holds and invests is restricted to the activities of the System by the donor. Because these restricted resources held by the Foundation can only be used by, or for the benefit of, the System, the Foundation is considered a component unit of the System and is included in the System's financial statements. The Foundation is reported as a discretely presented component unit of the System. Financial reports for the Foundation can be obtained from the Harris County Hospital District Foundation, 2525 Holly Hall, Suite 292, Houston, Texas 77054. Attention: Jeffrey Baker, Executive Director (Jeffrey.Baker@harrishealth.org).

Community Health Choice, Inc. and Community Health Choice Texas, Inc. (the HMOs) are Texas not-for-profit corporations organized under Section 501(c)(4) of the Internal Revenue Code to operate as health maintenance organizations. Community Health Choice, Inc. was incorporated on May 8, 1996, licensed by the Texas Department of Insurance on February 14, 1997 and as of December 31, 2016 offered three Medicaid insurance products as well as individual health insurance on the Health Insurance Marketplace for 358,601 enrollees. Community Health Choice Texas, Inc. was formed in August 2016 to allow the Health Insurance Marketplace and the Medicaid insurance products to be provided and served by separate corporations. Community Health Choice, Inc. is the Health Insurance Marketplace and commercial HMO with 140,210 enrollees as of December 31, 2017, and Community Health Choice Texas, Inc. is the Medicaid Managed Care HMO with 285,294 enrollees as of December 31, 2017. The HMOs are reported as discretely presented component units of the System since the Board of Directors are appointed by the System's Board of Trustees and the System can impose its will on the HMOs. The differences in amounts due to the System and due from the HMOs in the accompanying statements of net position are primarily due to the presentation of the HMOs financials based on their fiscal year-end of December 31. There is no financial activity to be presented for Community Health Choice Texas, Inc. in the System's financial statements as of February 28, 2017. Financial reports for the HMOs can be obtained from Community Health Choice, Inc., 2636 South Loop West, Ste.125, Houston, Texas 77054, Attention: Brian P. Maude, Executive Vice President and Chief Financial Officer (Brian.Maude@CommunityCares.com).

Unless otherwise noted, the following notes do not include the Foundation or the HMOs.

Note 2: Summary of Significant Accounting Policies

Basis of Accounting

The accompanying financial statements are prepared on the accrual basis of accounting. Certain prior year amounts have been reclassified to conform to the current year presentation. The reclassification had no effect on the change in financial position.

Method of Accounting

Under the provisions of the American Institute of Certified Public Accountants' *Audit and Accounting Guide*, *Health Care Organizations*, the System is considered a governmental organization and is subject to the pronouncements of the Governmental Accounting Standards Board (GASB).

In accordance with GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, the System's financial statements include the statements of net position; statements of revenues, expenses and changes in net position; and statements of cash flows.

The statement of net position requires that total net position be reported in three components (a) net investment in capital assets, (b) restricted; and (c) unrestricted.

- "Net investment in capital assets" consists of 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" consists of restricted assets reduced by liabilities and deferred inflows of resources related to the assets, and are primarily for debt service.
- "Unrestricted" is the net amount of the assets, deferred outflows of resources, liabilities, and deferred inflows of resources that are not included in the determination of net investment in capital assets or the restricted component of net position.

When an expense is incurred for purposes for which there are both restricted and unrestricted net position available, it is the System's practice to apply that expense to restricted net position to the extent such are available and then to unrestricted.

The Foundation is a private not-for-profit organization that reports under Financial Accounting Standards Board pronouncements. As such, certain revenue recognition criteria and presentation features are different from that of the GASB. The Foundation's financial statement formats were modified to make them compatible with the System's financial statement formats.

The HMOs are licensed only in the state of Texas and report under Governmental Accounting Standards Board pronouncements. The HMOs' financial statement formats were modified to make them compatible with the System's financial statement formats.

Principles of Reporting

The financial statements include the accounts of the System, the Foundation and the HMOs, as described in Note 1. In accordance with GASB Statement No. 61, *The Financial Reporting Entity: Omnibus – An Amendment of GASB Statements Nos. 14 and 34,* the System reports the HMOs and the Foundation as discretely presented component units in its financial statements. Management of the System believes the separate presentation of the System's statements and of each discretely presented component unit to be the most reflective of the System's activities.

Transactions between the System and its component units include the following:

The System provides certain administrative services to the HMOs including employment of all individuals who perform the day-to-day requirements of the business functions of the HMOs. The HMOs reimburse the System for such salaries, wages, and benefits and these costs are reflected as expenses of the HMOs. An additional fee for indirect costs approximating $1.6 million and $1.5 million for fiscal years 2018 and 2017, respectively, is included as a revenue and expense in the System/HMO financial statements. As permitted and limited by the state of Texas laws applicable to insurance companies, the HMOs' Board of Directors have approved certain agreements with the System and unrelated third parties whereby an allocation of surplus capital was committed to fund projects designed to further the HMOs' mission of providing quality healthcare to the underserved population of Southeast Texas. Funds transferred to the System under these agreements are reflected as contributions (distributions) in the statements of revenues, expenses and changes in net position.

The System supports the Foundation with payments for goods and services of approximately $569,000 and $593,000 in fiscal years 2018 and 2017, respectively, which are recognized in the Foundation financial data as in-kind contributions and expenses. The Foundation provided support to the System for projects and grants of $1,584,000 and $1,495,000 in 2018 and 2017, respectively. In addition, the Foundation distributed to the System contributions totaling $700,000 and $1,000,000 in 2018 and 2017, respectively, from its multi-year Capital Campaign funds.

Cash, Cash Equivalents and Short-term Investments

Cash and cash equivalents include cash and investments that are highly liquid with maturities of less than three months when purchased, and excludes cash and cash equivalents that are restricted or limited as to use. Short-term investments are investments with maturities in excess of three months, but less than a year, when purchased.

The System's and HMOs' 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 the *Texas Local Government Code*, except as disclosed in Note 6. Such total collateralization and insurance coverage is required by the Board of Trustees of the System. The Foundation's investments, however, are not subject to these laws.

Investments 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 position.

Foundation Net Position

The Foundation records contributions/pledges receivable as revenue in the period in which the promise is made and categorizes the contributions in accordance with donor-imposed restrictions, if any. When an externally imposed restriction expires or unrestricted contributions are realized, temporarily restricted net assets are reclassified to unrestricted net assets. Contributions for which restrictions are met in the same period in which the unconditional promise to give is received are recorded as unrestricted revenue. The majority of the pledges recorded are temporarily restricted to the System's expansion projects. Pledges are included in other assets in the statements of net position.

Inventories

Inventories are valued at the lower of cost, using the first-in, first-out method, or market and consist principally of pharmaceuticals.

Capital Assets

Property, plant and equipment are carried at cost or acquisition value at the time of donation and include expenditures for new facilities and equipment and expenditures that substantially increase the useful life of existing capital assets. Ordinary maintenance and repairs are charged to expense when incurred. Capitalization is limited to assets with a cost of $5,000 or greater.

Capitalized interest for assets financed by specific tax exempt borrowings is calculated based upon interest expense for the period, less investment income related to long-term debt for the same period.

Disposals are removed at carrying cost less accumulated depreciation, with any resulting gain or loss included in other nonoperating revenue and expenses. 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 leases 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 statements of revenues, expenses and changes in net position.

Compensated Absences

The System 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, unused benefits may be liquidated at 50 percent or at the time of termination, unused benefits are payable at 75 percent. Changes in the System's liability for compensated absences in fiscal years 2018 and 2017 are as follows (in thousands).

Fiscal Year	Beginning of Year Liability	Current Year Claims and Change in Estimates	Claim Payments	End of Year Liability
2018	$ 35,652	$ 69,984	$ 68,883	$ 36,753
2017	37,250	61,224	62,822	35,652

Classification of Revenues 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. Operating expenses include those related to direct patient care and related support services. Nonoperating expenses include interest expense and other expenses that are not considered operating.

Net Patient Service Revenue and Accounts Receivable

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. In recognizing net patient service revenue, estimates are used in recording allowances for contractual adjustments and noncollectible accounts. Allowances for noncollectible accounts are estimated using historical experience, current trend information, aged account balances and a collectability analysis. The System's financial assistance program for uninsured patients classified as self-pay determines expected payments based on the Medicare allowable reimbursement. Charges in excess of the expected payment are reflected as an administrative uninsured discount. The allowance for uncollectible accounts was estimated at $85.1 million and $94.2 million as of February 28, 2018 and 2017, respectively. The System provides services under contract to patients covered under the Medicare and Medicaid programs. Net revenues from these programs are included in patient service revenue at estimated reimbursement based on customary billing charges, predetermined rates of reimbursement, plus certain adjustments. The amounts due to or from these programs are subject to final review and settlement by the program fiscal intermediary. Retroactive adjustments under third-party reimbursement agreements 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. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, it is reasonably possible that these estimates could differ from actual settlements and thus change in the near term by material amounts. The System recognized an increase in net patient service revenue of $0.2 during 2018 and $1.1 million during 2017, respectively, from the differences between estimated and actual cost report settlements and appeals.

Charity Care Policy

The System accepts all Harris County residents as patients regardless of their ability to pay. Harris County residents may qualify for partial financial assistance, on a sliding scale. The extent to which a resident will be financially responsible is determined based upon pre-established financial criteria, which utilize family income and size as it relates to the federal poverty guidelines set by the U.S. Department of Health and Human Services. Charity services are defined as those services for which no payment is anticipated. These amounts are not reported as revenue. The System maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges foregone for services and supplies furnished under the System's Financial Assistance program. The following information measures the level of charity care provided during the years ended February 28, 2018 and 2017 (in thousands):

	2018	2017
Charges forgone, based on established rates	$ 1,402,321	$ 1,524,954
Cost of foregone charges, estimated	651,623	659,824

Premium Revenue

Premium revenue is recognized as revenue by the HMOs during the coverage period of the subscriber agreement. For the primary Medicaid business, notification is received throughout the year of any new, removed, or revised members and the date of eligibility for coverage. The date of notification may be subsequent to the date of eligibility. The HMOs believe premium revenue has been appropriately recognized for the years ended December 31, 2017 and 2016.

Medical Claims Expense

The HMOs arrange for comprehensive healthcare services to its members primarily through fee-for-service arrangements. The HMOs compensate hospitals on either a discounted fee for service or per diem basis and compensates physicians and other providers primarily on a discounted fee for service basis.

Medical claims expense reserves represent the estimated ultimate net cost of all reported and unreported losses incurred through the end of December and are presented on a discounted basis. 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.

Contracts are evaluated to determine if it is probable that a loss will be incurred and a premium deficiency reserve is recognized when it is probable that expected future claims, including maintenance costs, will exceed existing reserves plus anticipated future premiums and reinsurance recoveries, without consideration of anticipated investment income. For purposes of determining premium deficiency reserves, contracts are grouped in a manner consistent with the method of acquiring, servicing and measuring the profitability of such contracts. As of December 31, 2017 and 2016, the HMOs recognized no premium deficiency reserve for the Health Insurance Marketplace business.

Changes in the HMOs' aggregate liability for medical claims and the premium deficiency reserve in fiscal years 2018 and 2017 are as follows (in thousands):

Fiscal Year	Beginning of Fiscal Year Liability	Medical Claims and Change in Estimates	Claim Payments	Current-year Premium Deficiency Reserve	End of Fiscal Year Liability
2018	$ 111,728	$ 1,287,335	$ 1,240,160	$ -	$ 158,903
2017	85,138	946,324	919,734	-	111,728

In fiscal year 2018, the HMOs in aggregate paid $1,122.2 million in claims related to the current fiscal year and $117.9 million in claims related to the prior fiscal year. In fiscal year 2017, the HMOs paid $837.6 million in claims related to the current fiscal year and $82.1 million in claims related to the prior fiscal year.

The HMOs are a party to a reinsurance agreement to limit its losses on individual claims. Under the terms of the agreement, the reinsurer reimburses the HMOs approximately 90 percent, subject to certain limitations as specified in the contract, of the cost of each member's annual inpatient hospital services. For the Medicaid and CHIP business, the recovery is based on costs in excess of a $1,000,000 deductible, up to a limitation of $2,000,000 per member per agreement period. The HMOs also carry coverage for the Healthcare Insurance Marketplace (HIM) business for which the reinsurer reimburses approximately 90 percent of each member's annual inpatient hospital services in excess of a $450,000 deductible, up to a limitation of $2,000,000 per member per agreement period.

In addition, Section 1341 of the Affordable Care Act established a transitional reinsurance program to stabilize premiums in the individual market inside and outside of the marketplaces. The transitional reinsurance program will collect contributions from contributing entities to fund reinsurance payments to issuers of non-grandfathered reinsurance-eligible individual market plans, the administrative costs of operating the reinsurance program, and the General Fund of the

U.S. Treasury for the 2017 and 2018 benefit years. Coverage is provided through the Center for Medicare & Medicaid Services (CMS) and reimburse the HMOs approximately 50 percent of the cost of each marketplace member's annual medical services for which cumulative paid claims are between $90 and $250 thousand dollars.

Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010 (ACA)

The HMOs participate in the federally facilitated health insurance exchange in ten southeast Texas counties. The exchange was created pursuant to the ACA under regulations established by the U.S. Department of Health and Human Services (HHS). Under these rules, HHS pays the HMO a portion of the policy premium, in the form of Advanced Premium Tax Credit (APTC), and part of the health care costs, in the form of Cost Sharing Reduction (CSR), for low-income individual exchange members. HHS also administers certain risk management programs as detailed below.

The HMOs recognize premiums received from its exchange members and APTC received from HHS as premium revenue when earned and CSR offsets healthcare costs when incurred. A liability is recorded when the CSR is received and a receivable would be recorded if incurred costs exceed the CSR received to date. For 2018, the HMOs recognized $418.6 million and $68.9 million of APTC and CSR, respectively. For 2017, the HMOs recognized $215.9 million and $50.5 million of APTC and CSR, respectively.

The ACA established a temporary three-year reinsurance program, under which all issuers of major medical commercial insurance products and self-insured plan sponsors are required to contribute funding in amounts set by HHS. Funds collected under this program will be used to reimburse issuers' high claims costs incurred for individual members. The HMOs expense related to this required funding is recognized as a reduction of premium revenue. When annual claim costs incurred by individual members exceed a specified retention level, the HMOs are entitled to certain reimbursements from this program. Estimated recoveries are recorded as a receivable and a reduction to medical costs for the policy year involved. As of December 31, 2017 and 2016, the HMOs accrued $0.0 million and $10.0 million, respectively, for recoveries under this program.

The ACA also established a temporary three-year risk sharing (Risk Corridor) program for qualified individual and small group insurance plans. Under this program the HMOs will receive (or make) payments from (or to) HHS based on the ratio of allowable costs to target costs (as defined by HHS rules). The HMOs record Risk Corridor receivables or payables as adjustments to premium revenue on a year-to-date basis, based on our estimate of the ultimate risk sharing amount. At December 31, 2017 and 2016, the HMOs did not record a payable or receivable for the risk corridor program.

Finally, the ACA established a permanent risk adjustment program to transfer funds from qualified individual and small group insurance plans with below average risk scores to plans with above average risk scores. Based on the risk of their members relative to the average risk of members of other qualified plans in comparable markets, the HMOs estimate the ultimate risk adjustment receivable or payable and record the year-to-date impact as an adjustment to premium revenue. At December 31, 2017 and 2016 the HMOs recorded a risk adjustment payable of $51.7 million and $69.4 million, respectively.

Ad Valorem Tax Revenues – Net

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 System as provided under state law. The taxes are collected by the Harris County Tax Assessor – Collector and are remitted to the System as received. On January 1, at the time of assessment, an enforceable lien is attached to the property for property taxes. 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 also enters into property tax abatement agreements with local businesses under the state Property Redevelopment and Tax Abatement Act, Chapter 312, as well as its own guidelines and criteria, which is required under the Act.

Tobacco Settlement Revenues

In the fiscal years ended February 28, 2018 and 2017, the System received a portion of the funds from the settlement between various counties and hospital districts in Texas and the tobacco industry for tobacco-related healthcare costs. Under the program guidelines, the System is free to use the funds in either the immediate or future periods without restriction. The System recognizes all funds received from the settlement as nonoperating revenue in the period funds are allocated.

Pensions

For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the Harris County Hospital District Pension Plan (the Plan) and additions to/deductions from the Plan's fiduciary net position have been determined on the same basis as they are reported by the Plan. For this purpose, benefits payments are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles (GAAP) 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.

Newly Adopted Accounting Pronouncements

GASB Statement No. 74 – GASB Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*. The objective of this Statement is to improve the usefulness of information about postemployment benefits other than pensions. This Statement replaces Statement No. 43, Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans, as amended. The requirements of this Statement are effective for plan reporting for reporting periods beginning after June 15, 2016. At this time, the System has determined that the Statement is not applicable.

GASB Statement No. 80 – GASB Statement No. 80, *Blending Requirements for Certain Component Units – An Amendment of GASB Statement No. 14*. This Statement amends the blending requirements for the financial statement presentation of component units of all state and local governments. The *requirements* of the Statement are effective for reporting periods beginning after June 15, 2016. At this time, the System has determined that the Statement is not applicable.

GASB Statement No. 81 – GASB Statement No. 81, *Irrevocable Split-Interest Agreements*. The objective of this Statement is to improve accounting and financial reporting for irrevocable split-interest agreements by *providing* recognition and measurement guidance for situations in which a government is a beneficiary of the agreement. The requirements of the Statement are effective for periods beginning after December 15, 2016. At this time, the System has determined that the Statement is not applicable.

GASB Statement No. 82 – GASB Statement No. 82, *Pension Issues – an Amendment of GASB Statements No. 67, No. 68 and No. 73*. The Statement addresses the presentation of payroll-related measures in required supplementary information, the selection of assumptions and the treatment of *deviations* from the guidance in an actuarial Standard of Practice for financial reporting purposes, and the classification of payments made by employers to satisfy plan member contribution requirements. The requirements of this Statement are effective for periods beginning after June 15, 2016. All applicable provisions have been included in the System's financial statements as of February 28, 2018.

Pending Adoption of Recent Accounting Pronouncements

GASB Statement No. 75 – GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*. The objective of this Statement is to improve accounting and financial reporting by state and local governments for postemployment benefits other than pensions. The Statement is effective for employer fiscal years beginning after June 15, 2017. The System has not completed the process of evaluating the impact that will result from implementing the Statement.

GASB Statement No. 83 – GASB Statement No. 83, *Certain Asset Retirement Obligations*. The Statement addresses accounting and financial reporting for certain asset retirement obligations, a legally enforceable liability associated with the retirement of a tangible capital asset. The Statement is effective for periods beginning after June 15, 2018 with earlier application encouraged.

GASB Statement No. 84 – GASB Statement No. 84, *Fiduciary Activities.* The objective of this Statement is to improve guidance regarding the identification of fiduciary activities for accounting and financial reporting purposes and how those activities should be reported. The requirements of this Statement are effective for reporting periods beginning after December 15, 2018 with earlier application encouraged.

GASB Statement No. 85 – GASB Statement No. 85, *Omnibus 2017*. The Statement addresses a variety of issues identified during implementation and application of certain GASB Statements related to blending component units, goodwill, fair value measurement and application, and pensions and other postemployment benefits. The requirement of this Statement are effective for reporting periods beginning after June 15, 2017 with earlier application encouraged.

GASB Statement No. 86 – GASB Statement No. 86, *Certain Debt Extinguishment Issues* ("GASB86"); Statement No. 7, Advance Refunding Resulting in Defeasance of Debt, requires that debt be considered defeased in substance when the debtor irrevocably places cash or other monetary assets acquired with refunding debt proceeds in a trust to be used solely for satisfying scheduled payments of both principal and interest of the defeased debt. Statement No. 86 establishes essentially the same requirements for transactions in which cash and other monetary assets acquired with only existing resources, resources other than the proceeds of refunding debt, are placed in an irrevocable trust for the sole purpose of extinguishing debt. The requirements of this Statement are effective for reporting periods beginning after June 15, 2017, with earlier application encouraged.

GASB Statement No. 87 – GASB Statement No. 87, *Leases.* This statement requires recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. The requirements of this Statement are effective for reporting periods beginning after December 15, 2019, with earlier application encouraged.

GASB Statement No. 88 – GASB Statement No. 88, *Certain Disclosures Related to Debt, Including Direct Borrowings and Direct Placements.* This Statement requires disclosure of additional essential information related to debt that is not consistently provided. The Statement clarifies which liabilities should be included when disclosing information related to debt and also requires that existing and additional information be provided for direct borrowings and direct placements of debt separately from other debt. The requirements of this Statement are effective for reporting periods beginning after June 15, 2018, with earlier application encouraged.

Note 3: Net Patient Service Revenue

The System has agreements with third-party payors that provide for payments to the System 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 System's Medicare cost reports have been audited by the Medicare administrative contractor through February 29, 2012.

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 services are paid by fee schedules for specific services, including outpatient surgery, imaging and laboratory services. Other outpatient services are reimbursed on reasonable cost, based on a percentage from the hospital's most recent Medicaid cost report tentative settlement as of August 31, 2013. The System's Medicaid cost reports have been settled by the Medicaid administrative contractor through February 29, 2012.

Cash received from the Medicare program accounted for approximately 37 percent and 35 percent of the System's total cash collections for net patient service revenue for years ended February 28, 2018 and 2017, respectively. Cash received from the Medicaid program (including managed Medicaid) accounted for approximately 39 percent and 41 percent of the System's total cash collections for net patient service revenue for the years ended February 28, 2018 and 2017, respectively.

Compliance with laws and regulations governing the Medicare and Medicaid programs 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.

Note 4: Medicaid Supplemental Programs

The Disproportionate Share III (DSH) program was created in fiscal 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 Upper Payment Limit (UPL) program was created in May 2002 with an effective date of July 2001. The UPL program used federal matching funds to raise state Medicaid reimbursement rates to 100 percent of equivalent Medicare rates for certain public hospital systems. In December 2011, Texas received federal approval to redirect the funding it would have received under the UPL program over the next five years into a new reform plan (1115 Waiver). The 1115 Waiver has been renewed through September 2022. The 1115 Waiver allows the state to expand Medicaid managed care, improve Medicaid services and reward performance. Federal funding that would have been received by hospitals if managed care was not expanded is to be preserved. The upper payment limit program was replaced with two new pools of funding, the uncompensated care (UC) pool and the delivery system reform incentive payment (DSRIP) pool. The UC pool directs more funding to hospitals that serve large numbers of uninsured patients and the DSRIP pool provides incentive payments for healthcare providers based on improvements in quality of care. As of February 28, 2018 the System also participates in two other Medical Supplemental Payment Programs, the Network Access Improvement Program (NAIP) and the new Uniform Hospital Rate Increase Program (UHRIP).

The System recognizes all funds received under the DSH, UC, DSRIP, NAIP and UHRIP programs as operating revenues in the period applicable to the funds. Prior to 2017, the System recognized funds received under the DSRIP program as nonoperating revenues. 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 statements of net position. These receivables can be subject to adjustments that are reflected in the period they become known. The System recorded a favorable adjustment of $1.8 million and $2.8 million in fiscal year 2018 and 2017, respectively, for prior years' programs. The System's financial statements reflect current liabilities of $14.4 million and $14.0 million at February 28, 2018 and 2017, respectively and receivable of $22.1 million and $1.9 million at February 28, 2018 and 2017, respectively, related to the Medicaid Supplemental Programs.

Note 5: Assets Limited as to Use or Restricted

Assets limited as to use or restricted represent those assets whose use has been legally restricted related to the 2010 and 2016 refunding and revenue bond issues (50 percent of the greatest debt service requirement scheduled to occur); unspent bond proceeds; funds restricted by donors; or funds designated by the board for other uses. Investments in U.S. Treasury, agency and instrumentality obligations with a remaining maturity of one year or less at the time of acquisition and in nonnegotiable certificates of deposit are carried at amortized cost. All other investments are recorded at fair value. The fair values of securities are based on appropriate valuation methodologies by third parties, quoted market prices and information available to management as of February 28, 2018 and 2017. The components of assets limited as to use or restricted at fair value at February 28, 2018 and 2017 are as follows (in thousands):

	2018				
Description of Assets	Total	Restricted Debt Service	BT Level 1 Trauma	Cash on Deposit with Harris County Project Management	Other
Money market government funds	$ 15,684	$ 143	$ 15,295	$ -	$ 246
Commercial paper	48,113	19,773	27,773	-	567
Government securities	21,300	11,187	10,113	-	-
Other	59,479	-	-	59,479	-
	144,576	31,103	53,181	59,479	813
Less funds required for current liabilities	(6,352)	(6,352)	-	-	-
	$ 138,224	$ 24,751	$ 53,181	$ 59,479	$ 813

	2017				
Description of Assets	Total	Restricted Debt Service	BT Level 1 Trauma	Cash on Deposit with Harris County Project Management	Other
Money market government funds	$ 7,767	$ 1,775	$ 5,735	$ -	$ 257
Commercial paper	34,903	19,271	15,070	-	562
Government securities	42,200	2,299	39,901	-	-
Other	35,361	-	-	35,361	-
	120,231	23,345	60,706	35,361	819
Less funds required for current liabilities	(6,111)	(6,111)	-	-	-
	$ 114,120	$ 17,234	$ 60,706	$ 35,361	$ 819

The System has contracted with Harris County for the management of certain infrastructure projects. Under the agreement, the System deposits with the County estimated funds required for the completion of each project. The funds are held by the County for those project expenditures with any remaining amounts refunded upon project completion.

Foundation – Assets limited as to use of $29.2 million and $25.4 million at February 28, 2018 and 2017, respectively, are restricted subject to donor-imposed stipulations that will be met by actions of the Foundation or the passage of time.

Note 6: Investment Risk

GASB Statement No. 40, *Deposit and Investment Risk Disclosures – an amendment of GASB Statement No. 3*, requires disclosures related to credit risk, concentration of credit risk, interest rate risk, and foreign currency risk associated with interest-bearing investments.

Credit Risk and Concentration of Credit Risk – Credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization (NRSRO). The System, the HMOs and the Foundation each have formal investment policies adopted by their governing boards, which limit investment in securities based on an NRSRO credit rating. The System's investments are also subject to the Public Funds Investment Act (the Act), Texas Administrative Code Section 2256, and the investments of the HMOs are also subject to regulations enumerated in Title 28, Chapter 11 of the Texas Administrative Code and Chapter 20A of the Texas Insurance Code. The Foundation's investments are not subject to these laws.

The System's investment policy is to be reviewed and approved annually by the Board of Trustees and the Commissioners' Court. The investment policy includes a list of authorized investment instruments, a maximum allowable stated maturity by fund type and the maximum weighted average maturity of the overall portfolio. Guidelines for diversification and risk tolerance are also detailed within the policy. Additionally, the policy includes specific investment strategies for fund groups that address each group's investment options and describes the priorities for suitable investments.

The System's investment policy establishes minimum acceptable credit ratings for certain investment instruments. Securities of states, agencies, counties, cities, and other political subdivisions must be rated as to investment quality by a nationally recognized investment-rating firm as A or its equivalent. Money market mutual funds and public funds investment pools must be rated Aaa or its equivalent.

Concentration of credit risk is the risk of loss attributed to the magnitude of an investment in a single issuer. The System mitigates these risks by emphasizing the importance of a diversified portfolio. All funds must be sufficiently diversified to eliminate the risk of loss resulting from overconcentration of assets in a specific maturity, a specific issuer or a specific class of securities. In particular, no more than 25 percent of the overall portfolio may be invested in time deposits, including certificates of deposit, of a single issuer. Concentration by issuer for other investment instruments is not specifically addressed in the investment policy. However, the policy does specify that acceptable investment instruments must have high-quality credit ratings.

GASB Statement No. 40 also provides that securities with split ratings, or a different rating assignment between NRSROs, are disclosed using the rating indicative of the greatest degree of risk.

The table below indicates the fair value and maturity amount of the System's cash equivalents, assets limited as to use and investments as of February 28, 2018 and 2017 summarized by security type. The table below presents the percentage of total portfolio, the credit rating of the investment, and the modified duration in years for each summarized security type (in thousands).

	2018				
Security	**Fair Value**	**Percentage of Portfolio**	**Maturity Amount**	**Modified Duration (Years)**	**Credit Rating S&P/Rating Moody's**
Commercial paper:					
Toyota Motor Credit Corp (TM	$ 424,997	50.57 %	$ 428,036	0.357	A-1+
Exxon Mobile Corp	19,939	2.37	20,000	0.178	A-1+
GE Capital Corporation	168,347	20.03	170,578	0.613	A-1-
U.S. agency notes:					
FHLMC note	9,960	1.19	10,000	0.496	AAA/Aaa
U.S. Treasury note	60,986	7.26	61,182	0.375	AAA/Aaa
Money market mutual funds	156,198	18.58	156,198	0.003	AAA/Aaa
Total cash equivalents, assets limited as to use and investments	$ 840,427	100.00 %	$ 845,994	0.342	

	2017				
Security	Fair Value	Percentage of Portfolio	Maturity Amount	Modified Duration (Years)	Credit Rating S&P/Rating Moody's
Commercial paper:					
TMCC	$ 313,826	36.47 %	$ 314,885	0.321	A-1+
Mitsubishi UFJ Financial Group	69,677	8.10	70,000	0.485	A-1-
GE Capital Corporation	143,893	16.72	145,000	0.620	A-1-
Other:					
Austin Texas Water & Wastewater System	1,054	0.12	1,055	0.712	AA,Aa2
San Diego Unified School District	1,239	0.14	1,240	0.337	AA,Aa2
U.S. agency notes:					
FHLB Note	29,947	3.48	30,000	0.725	AAA/Aaa
FHLMC Note	79,964	9.29	80,000	0.529	AA+/Aaa
U.S. Treasury Note	154,634	17.98	154,776	0.892	AAA/Aaa
Money market mutual funds	66,241	7.70	66,241	0.003	AAA/Aaa
Total cash equivalents, assets limited as to use and investments	$ 860,475	100.00 %	$ 863,197	0.496	

The System maintained no investments in derivatives at February 28, 2018 and 2017.

Custodial Credit Risk – Custodial credit risk for deposits is the risk that, in the event of failure of a depository financial institution, the System will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, the System will not be able to recover the value of its investment or collateral securities that are in the possession of another party.

Chapter 2257 of the Texas Government Code is known as the Public Funds Collateral Act. This act provides guidelines for the amount of collateral that is required to secure the deposit of public funds. Federal Deposit Insurance Corporation (FDIC) insurance is available for funds deposited at any one financial institution up to a maximum of $250,000 each for demand deposits, time and savings deposits, and deposits pursuant to indenture.

The Public Funds Collateral Act requires that the deposit of public funds be collateralized in an amount not less than the total deposit, reduced by the amount of FDIC insurance available.

At February 28, 2018 and 2017, the balance per the bank of Community Health Choice, Inc. demand and time deposits was $6.2 million and $2.9 million, respectively, of which $6.0 million and $2.6 million, respectively, was uninsured and uncollateralized.

The System's deposits are not exposed to custodial credit risk since all deposits are either covered by FDIC insurance or collateralized with securities held by the System or its agent in the System's name, in accordance with the Public Funds Collateral Act.

Interest Rate Risk – All investments carry the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. One of the ways that the System manages its exposure to interest rate risk is by purchasing a combination of shorter and longer-term investments and by matching cash flows from maturities so that a portion of the portfolio is maturing evenly over time as necessary to provide the cash flow and liquidity needed for operations.

According to the System's investment policy, no more than 50 percent of the portfolio, excluding those investments held for future capital expenditures, debt service payments, bond fund reserve accounts, and capitalized interest funds, may be invested beyond 36 months. Additionally, at least 15 percent of the portfolio, with the previous exceptions, is invested in overnight instruments or in marketable securities that can be sold to raise cash within one day's notice. Overall, the average maturity of the portfolio, with the previous exceptions, shall not exceed three years. As of February 28, 2018 and 2017, the System was in compliance with these guidelines.

Foreign Currency Risk – Foreign currency risk is the risk that fluctuations in the exchange rate will adversely affect the value of investments denominated in a currency other than the U.S. dollar. The System's investment policy does not list securities denominated in a foreign currency among the authorized investment instruments. Consequently, the System is not exposed to foreign currency risk.

The table below indicates the fair value and maturity amount of the cash equivalents, assets limited as to use and investments of Community Health Choice, Inc. as of December 31, 2017 and 2016 summarized by security type. Also demonstrated are the percentage of total portfolio and the modified duration in years for each summarized security type (in thousands).

	2017				
Security	Fair Value	Percentage of Portfolio	Maturity Amount	Modified Duration (Years)	Credit Rating S&P/Rating Moody's
Municipal securities	$ 8,059	3.71 %	$ 8,085	0.455	AAA/Aaa
Certificates of deposit	3,325	1.53	3,325	0.479	AAA
Money market mutual funds	205,955	94.76	205,955	0.003	AAA
Total cash equivalents, assets limited as to use and investments	$ 217,339	100.00 %	$ 217,365	0.312	

Security	Fair Value	Percentage of Portfolio	Maturity Amount	Modified Duration (Years)	Credit Rating S&P/Rating Moody's
	2016				
Commercial paper:					
Toyota Motor Credit Corp	$ 89,753	33.45 %	$ 90,000	0.284	A-1+
Certificates of deposit	3,326	1.24	3,326	0.429	AAA
Money market mutual funds - Amegy Bank	175,224	65.31	175,224	0.007	AAA
Total cash equivalents, assets limited as to use and investments	$ 268,303	100.00 %	$ 268,550	0.836	

The table below indicates the fair value and maturity amount of the cash equivalents, assets limited as to use and investments of Community Health Choice Texas, Inc. as of December 31, 2017 summarized by security type. Also demonstrated are the percentage of total portfolio and the modified duration in years for each summarized security type (in thousands).

Security	Fair Value	Percentage of Portfolio	Maturity Amount	Modified Duration (Years)	Credit Rating S&P/Rating Moody's
	2017				
Municipal bonds	$ 30,473	35.72 %	$ 30,728	0.998	AAA/Aaa
Certificates of deposit	600	0.70	600	0.185	AAA
Money market mutual funds	54,248	63.58	54,248	0.003	AAA
Total cash equivalents, assets limited as to use and investments	$ 85,321	100.00 %	$ 85,576	0.345	

The System categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The hierarchy is based on the valuation inputs used to measure fair value of the assets. Level 1 are quoted prices in an active market for identical assets, Level 2 are significant other observable inputs and Level 3 are significant unobservable inputs.

The following is a summary of the hierarchy of the fair value of cash equivalents, assets limited as to use, investments, and derivative instrument (Note 8) of the System as of February 28, 2018 and 2017 (in thousands).

	2018 Fair Value Measurements Using			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Commercial paper	$ -	$ 613,283	$ -	$ 613,283
U.S. agency notes	-	70,946	-	70,946
Money market mutual funds	156,198	-	-	156,198
Total cash equivalents, assets limited as to use and investments by fair value	$ 156,198	$ 684,229	$ 0	$ 840,427
Derivative financial instrument	$ 0	$ 6,437	$ 0	$ 6,437

	2017 Fair Value Measurements Using			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Commercial paper	$ -	$ 527,396	$ -	$ 527,396
Other municipal securities	-	2,293	-	2,293
U.S. agency notes	-	264,545	-	264,545
Money market mutual funds	66,241	-	-	66,241
Total cash equivalents, assets limited as to use and investments by fair value	$ 66,241	$ 794,234	$ 0	$ 860,475
Derivative financial instrument	$ 0	$ 9,388	$ 0	$ 9,388

The following is a summary of the hierarchy of the fair value of investments and cash equivalents of Community Health Choice, Inc. as of December 31, 2017 and 2016 (in thousands):

	2017 Fair Value Measurements Using			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Other municipal securities	$ -	$ 8,059	$ -	$ 8,059
Money market mutual funds	205,955	-	-	205,955
Total investments and cash equivalents by fair value level	$ 205,955	$ 8,059	$ 0	$ 214,014

	2016 Fair Value Measurements Using			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Commercial paper	$ -	$ 89,753	$ -	$ 89,753
Money market mutual funds	177,452	-	-	177,452
Total investments and cash equivalents by fair value level	$ 177,452	$ 89,753	$ 0	$ 267,205

The following is a summary of the hierarchy of the fair value of investments and cash equivalents of Community Health Choice Texas, Inc. as of December 31, 2017 (in thousands):

	2017 Fair Value Measurements Using			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Other municipal securities	$ -	$ 30,473	$ -	$ 30,473
Money market mutual funds	54,248	-	-	54,248
Total investments and cash equivalents by fair value level	$ 54,248	$ 30,473	$ 0	$ 84,721

Note 7: Capital Assets

The System's investment in capital assets as of February 28, 2018 and 2017, consists of the following (in thousands).

	2018			
	Beginning Balance	Additions/ Transfers	Retirements	Ending Balance
Land and improvements	$ 42,012	$ 1,084	$ -	$ 43,096
Buildings and fixed equipment	616,643	27,686	(2,839)	641,490
Major movable equipment	351,041	34,038	(19,965)	365,114
Total historical cost	1,009,696	62,808	(22,804)	1,049,700

	2018			
	Beginning Balance	Additions/ Transfers	Retirements	Ending Balance
Less accumulated depreciation:				
Land and improvements	$ (11,374)	$ (1,052)	$ -	$ (12,426)
Buildings and fixed equipment	(332,905)	(24,698)	2,140	(355,463)
Major moveable equipment	(269,720)	(28,213)	18,629	(279,304)
Total accumulated depreciation	(613,999)	(53,963)	20,769	(647,193)
Construction in progress	26,312	7,147	-	33,459
Capital assets - net	$ 422,009	$ 15,992	$ (2,035)	$ 435,966

	2017			
	Beginning Balance	Additions/ Transfers	Retirements	Ending Balance
Land and improvements	$ 41,792	$ 220	$ -	$ 42,012
Buildings and fixed equipment	606,667	11,044	(1,068)	616,643
Major movable equipment	338,486	27,801	(15,246)	351,041
Total historical cost	986,945	39,065	(16,314)	1,009,696
Less accumulated depreciation:				
Land and improvements	(10,282)	(1,092)	-	(11,374)
Buildings and fixed equipment	(310,515)	(23,420)	1,030	(332,905)
Major moveable equipment	(254,686)	(29,707)	14,673	(269,720)
Total accumulated depreciation	(575,483)	(54,219)	15,703	(613,999)
Construction in progress	20,015	6,297	-	26,312
Capital assets - net	$ 431,477	$ (8,857)	$ (611)	$ 422,009

Depreciation expense for the years ended February 28, 2018 and 2017 was $54.0 million and $54.2 million, respectively.

Note 8: Long-term Debt

Long-term debt of the System consists of various issues of Revenue Bonds and Combination Tax and Revenue Certificates of Obligation (Certificates). Revenue Bonds are payable from the pledged revenue generated by the System. Combination Tax and Revenue Certificates of Obligation are payable from the levy and collection of an ad valorem tax, levied on taxable property with the District. Although taxes are levied and collected by Harris County for the System, the Certificates are direct obligations of the System and the holders are not entitled to demand payment from any tax revenue or other revenues of Harris County.

Revenue Bonds

On October 3, 2007, the System issued two Series of Harris County Hospital District Senior Lien Refunding Revenue Bonds (the Bonds). The Series 2007A Bonds, in the amount of $199,085,000, were sold to provide funding for expansion and renovation projects, to refund the System's outstanding commercial paper, to fund the Debt Service Reserve Fund, and to pay costs of issuance. The Series 2007B Bonds, in the amount of $103,525,000, were used to refund the Series 2000 revenue bonds and to pay costs of issuance. The Series 2007 Bonds are insured by municipal bond insurance policies and secured by a lien on the pledged revenue of the System and certain funds established pursuant to the bond order.

In October 2016, the System refunded and refinanced the Series 2007A Bonds by issuing the $160,220,000 Series 2016 Senior Lien Refunding Revenue bonds at a premium of $15,425,353. The proceeds of the Series 2016 Bonds and existing debt service and debt service reserve funds covered cost of issuance and defeased the Series 2007A bonds in the principal amount $177,820,000. An irrevocable deposit of sufficient funds with trustees was made to pay the principal and interest of the defeased bonds through maturity. In February 2017, the System paid the non-refunded principal balance due and related interest. The Series 2016 Bonds have a final maturity of February 15, 2042. The bonds were issued as serial bonds in the amount of $106,360,000 maturing February 15, 2036 and $53,860,000 in term bonds maturing February 15, 2042. The bonds maturing on or after February 15, 2027, are subject to optional redemption on or after February 15, 2026. The term bonds are additionally subject to mandatory sinking fund redemption. The refunding resulted in a net present value economic gain of $37 million.

The Series 2007B Bonds have a final maturity date of February 1, 2042, and were initially issued as 28-day taxable auction-rate paper, convertible to tax exempt on August 16, 2010. In April 2008, these bonds were converted from auction-rate securities and reoffered as variable rate bonds bearing interest at a term rate during a term period. The 2007B Bonds Series were hedged with a forward starting swap effective upon the tax-exempt conversion of the bonds.

In August 2010, the System refunded and refinanced the Series 2007B Bonds by issuing Series 2010 Refunding and Revenue bonds in the amount of $104,435,000. The proceeds of the Series 2010 Bonds covered costs of issuance and defeased the Harris County Hospital District Senior Lien Refunding Revenue Bonds, Series 2007B, in the principal amount of $103,525,000 through the irrevocable deposit of sufficient funds with trustees to pay the principal and interest of such bonds through maturity. Accordingly, these trusteed funds and the related defeased indebtedness are excluded from the balance sheet. The refunding resulted in a loss of $21.5 million, which includes $16.2 million deferred loss on refunding related to the interest rate swap, which has been deferred and is being amortized over the life of the Series 2007B Bond issue.

The remaining loss on refunding of $5.3 million has been deferred and is being amortized to interest expense over the life of the Series 2000 bond issue. The primary components of this loss were the write-offs of unamortized deferred financing costs and bond premiums, the net deferred amount related to the hedging derivative instrument associated with the 2007B Bonds and the difference between amounts funded for the defeasance and the principal due on the 2007B Bonds. The financial statements reflect deferred outflows-unamortized debt refunding loss of $10.3 million and $12.2 million at February 28, 2018 and 2017, respectively. Principal amounts of total defeased indebtedness outstanding at February 28, 2018 and 2017 are $85.9 million and $91.7 million, respectively. The bonds are secured by an irrevocable letter of credit issued by JPMorgan Chase Bank.

The Series 2010 Refunding and Revenue bonds in the amount of $104,435,000 are variable rate demand bonds maturing through February 15, 2042. The bonds are subject to purchase on the demand of the owner at a price equal to purchase price on any given business day upon irrevocable notice by electronic means to the System's tender agent and remarketing agent.

Under an irrevocable letter of credit issued by JPMorgan Chase Bank, only the tender agent is entitled to draw an amount sufficient to pay the principal amount of the bonds when due, or to pay the portion of the purchase price corresponding to the principal amount upon certain tenders. The letter of credit facility's expiration date of August 12, 2017 has been amended and extended to August 12, 2019. Unreimbursed advances will accrue interest at the higher of (i) the Prime Rate, (ii) one-month LIBOR plus 2.5 percent, or (iii) 7.5 percent per annum. The System is also required to pay to the JPMorgan Chase Bank an annual facility fee for the letter of credit of 0.80 percent per annum of the outstanding principal amount of the bonds. No amounts were outstanding on the letter of credit as of February 28, 2018 and 2017. In addition, the System is required to pay the remarketing agent an annual fee of $1.00 per $1,000 of principal amount of the bonds actually remarketed.

Compliance

The System is in compliance with its debt covenants at February 28, 2018 and 2017.

Interest Rate Swap

Related Bonds – On September 25, 2007, the System entered into an interest rate swap agreement in connection with its $103,525,000 Harris County Hospital District Senior Lien Revenue and Refunding Bonds, Series 2007B with the settlement date on October 3, 2007. On August 12, 2010, when the System refunded and refinanced the Series 2007B Bonds by issuing Series 2010 Bonds, the interest rate swap was redesignated and associated with the new debt. The derivative contained an off market element equal to the value of the swap associated with the Series 2007B Bonds on August 12, 2010. In accordance with GASB Statement No. 53, *Accounting and*

Financial Reporting for Derivative Instruments, this off-market element is recorded as a borrowing payable and is amortized as an adjustment to interest expense over the life of the swap agreement.

Objective of the Swap – The intention of the swap was to effectively reduce the impact of the System's variable interest rate exposure on the Related Bonds to a synthetic fixed rate of 4.218 percent.

Swap terms:

Trade date	September 12, 2007
Effective date	August 16, 2010
Termination date	February 15, 2042
Initial notional amount	$103,500,000
District pays fixed	4.218%
Counterparty pays floating	SIFMA Municipal Swap Index
Payment dates	Monthly on the 15th calendar day of every month

As further defined in the confirmation to the swap agreement, the System is subject to an "Annual Counterparty Ceiling" which limits the maximum payment, inclusive of collateral, made by the System in any fiscal year to $40,000,000. Subject to cash settlement, the System has the right to terminate the agreement, in whole or in part, on the Effective Date, August 16, 2010, and on any Business Day (as observed by New York and London financial markets) thereafter.

The effectiveness of the interest rate swap has been measured using the regression analysis method. The System has concluded that the transactions are effective.

Fair Value – The redesignated swap that is associated with the new debt had a zero fair value at its inception date and a fair value of $(6.4) million and $(9.4) million at February 28, 2018 and 2017, respectively, and is reported as a derivative liability in the statements of net position. The fair value of the swap was determined by calculating the present value of the anticipated future cash flows for both the floating portion and the stated fixed rate portion using discount factors derived from the London Interbank Offered Rate (LIBOR) swap curve.

Interest Rate Risk – The System is exposed to interest rate risk in that as the variable rates on the swap agreements decrease the System's net payment in the swap agreement could increase.

Basis Risk – The System is exposed to basis risk when the variable interest rate paid to the holders of its variable rate demand obligations is not equivalent to the variable interest rate received from its counterparties on the related swap agreements. When exposed to basis risk, the net interest expense incurred on the combination of the swap agreement and the associated variable rate debt may be higher or lower than anticipated.

Collateral Posting Risk – The risk that the System will be required to secure its obligations under the swap agreement. Any securities posted as collateral would not be available for the System's expenditure or reserve needs, which could adversely impact credit ratings and overall liquidity and budgetary efforts. The System was not exposed to collateral posting risk as of and for the years ended February 28, 2018 and 2017.

Credit Risk – The risk of a change in the credit quality or credit rating of the System and/or its counterparty. As of February 28, 2018, the swap counterparty was rated A- by Standard & Poor's, Baa2 by Moody's Investor Services, and BBB+ by Fitch. As of February 28, 2017, the swap counterparty was rated BBB+ by Standard & Poor's and Baa2 by Moody's Investor Services, and A- by Fitch. At February 28, 2018, the System was rated A by Standard & Poor's, A2 by Moody's Investor Services, and AA by Fitch. At February 28, 2017, the System was rated A by Standard & Poor's, A2 by Moody's Investor Services, and AA by Fitch.

Rollover Risk – The System is exposed to rollover risk only on swaps that mature or may be terminated at the counterparty's option prior to the maturity of the associated debt. As of February 28, 2018 and 2017, the System was not exposed to rollover risk.

Termination Risk – The System's swap agreements do not contain any out-of-the-ordinary termination events that would expose it to significant termination risk. In keeping with market standards, the System or the counterparty may terminate each swap if the other party fails to perform under the terms of the contract. In addition, the swap documents allow either party to terminate in the event of a significant loss of creditworthiness. If at the time of the termination a swap has a negative value, the System would be liable to the counterparty for a payment equal to the fair value of such swap. As of February 28, 2018 and 2017, termination of the original swap agreement would create a liability of $17.8 million and $21.4 million, respectively, and would result in a reversal of the derivative liability related to the redesignated swap, the borrowing payable amount and the unamortized loss on refunding. Any resulting net change would be recorded through nonoperating expenses.

Swap Payments – Using interest rates as of February 28, 2018, debt service requirements of the System's outstanding fixed and variable-rate debt and net swap payments on the variable-rate debt were as follows (in thousands). As rates vary, variable rate interest rate payments on the bonds and net swap payments will change.

2018				
Years Ending February	Debt Principal	Debt Interest	Swaps, Net	Total
2019	$ 5,915	$ 10,364	$ (1,721)	$ 14,558
2020	6,175	10,086	(1,678)	14,583
2021	6,470	9,796	(1,630)	14,636
2022	6,765	9,491	(1,586)	14,670
2023	7,080	9,173	(1,537)	14,716
2024-2028	40,690	40,542	(6,875)	74,357
2029-2033	50,975	30,194	(5,308)	75,861
2034-2038	61,785	19,196	(3,400)	77,581
2039-2042	58,825	5,988	(1,057)	63,756
Total	$ 244,680	$ 144,830	$ (24,792)	$ 364,718

Hybrid Instrument Borrowings – The System's interest rate swap includes fixed rates that were off market at the execution of the interest rate swap. For financial reporting purposes, the interest rate swap is considered a hybrid instrument and is bifurcated between borrowings, with an aggregate original amount of $18 million reflecting the fair value of the instrument at its execution, and an interest rate swap with a fixed rate that was considered at the market at execution. Activity for the hybrid instrument borrowings for the years ended February 28, 2018 and 2017 was as follows (in thousands).

	2018	2017
Beginning balance	$ 11,932	12,742
Reductions	(793)	(810)
Ending balance	$ 11,139	11,932

The following table sets forth as of February 28, 2018, the amortization of the hybrid instrument borrowings for the next five years and thereafter (in thousands).

		2018
Years ending February:		
2019	$	773
2020		754
2021		733
2022		712
2023		690
2024-2028		3,089
2029-2033		2,386
2034-2038		1,527
2039-2042		475
Total	$	11,139

Certificates of Obligation

In August 2016, the System issued Combination Tax and Revenue Certificates of Obligation, Series 2016 in the principal amount of $62,815,000. The funds are to be used to expand the operative suites and supporting services at Ben Taub Hospital necessary to maintain the facility's Level 1 Trauma status. The bonds mature in February 2036. The System's financial statements reflect $59.5 million and $61.6 million in outstanding principal and $6.9 million and $7.6 million in unamortized premium related to this debt at February 28, 2018 and 2017, respectively. Principal and interest paid was $4.7 million and $2.7 million, and tax revenue applicable to debt service was $4.7 million and $6.9 million for 2018 and 2017, respectively. Annual debt service requirements to maturity as of February 28, 2018 are as follows (in thousands):

	2018					
	Principal		Interest		Total	
Years ending February:						
2019	$	2,190	$	2,504	$	4,694
2020		2,295		2,394		4,689
2021		2,410		2,280		4,690
2022		2,530		2,159		4,689
2023		2,660		2,033		4,693
2024-2028		15,270		8,185		23,455
2029-2033		19,080		4,379		23,459
2034-2036		13,055		1,014		14,069
Total	$	59,490	$	24,948	$	84,438

Other Obligations

Other long-term obligations at February 28, 2018, are as follows (in thousands):

	2018		
	Principal	Interest	Total
Years ending February:			
2019	$ 75	$ 6	$ 81
2020	76	4	80
2021	50	3	53
2022	38	1	39
2023	10	-	10
Total	$ 249	$ 14	$ 263

Note 9: Employee Benefit Plans

The System currently maintains two benefit plans allowing employees to plan and save for retirement: a defined contribution plan and a defined benefit plan. In October 2006, the Harris County Hospital District Board of Trustees amended the defined benefit pension plan to close enrollment. The amended plan offers employees hired prior to January 1, 2007, a choice to either (1) continue with their current pension plan or (2) elect to participate in the System's enhanced 401(k) retirement savings plan with a match, effective July 2007, of up to 5 percent of participant's compensation provided by the System. All new hires and rehires after December 31, 2006, are only eligible for the System's 401(k) retirement savings plan with a match of up to 5 percent. The change was designed to safeguard individuals approaching retirement, who had accumulated a large pension benefit in the current plan, while providing employees who planned to work many more years an option for better flexibility and portability in the System's enhanced 401(k) plan.

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

Defined Contribution Plan

The System 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) (401(k) Plan) open to all full-time and part-time employees of the System who meet the plan's requirements. It is a single-employer, self-administered, trusteed plan to which contributions are made by participants on a biweekly basis not to exceed the statutory maximum of $18,000 during calendar years 2017 and 2016 for all participants. Contributions to the plan cannot exceed the statutory maximum of $24,000 during calendar years 2017 and 2016 for participants age 50 and older. Effective July 2007, the System enhanced the 401(k) Plan with an employer match up to 5 percent of the participant's compensation for eligible employees, which is 100 percent vested with three or more years of service. The 401(k) Plan is a governmental plan and, as such, is specifically exempt from the reporting and disclosure requirements of Title I of the Employee Retirement Income Security Act of 1974 (ERISA). Total participant contributions were $28.9 million and $26.4 million in fiscal years 2018 and 2017, respectively. Total System contributions were $11.7 million and $9.8 million in fiscal years 2018 and 2017, respectively.

Forfeitures under the 401(k) Plan for a plan year will be applied to reduce the System's obligation to make future matching contributions or to pay 401(k) Plan administrative expenses for the 401(k) Plan year. During the years ended December 31, 2017 and 2016, System contributions were reduced by approximately $0.9 million and $1.1 million, respectively from forfeited non-vested accounts.

Pension Plan

The System has a noncontributory, defined benefit pension plan (the Plan). It is a single-employer, self-administered, trusteed plan in which a separate stand-alone financial report is issued. The Plan is administered by an Administrative Committee appointed by the Board of Trustees of the System, which is responsible for administering the Plan under the terms that are established. The Board of Trustees approves amendments to the Plan. State Street Bank & Trust Co. serves as the trustee and custodian for the Plan. As a unit of local government, the Plan is not covered by ERISA. The Plan is funded through actuarially determined contributions by the System. The entry age normal 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 1.5 percent 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 1.5 percent 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 Administrative Committee.

As of January 1, 2017 and 2016, the following employees were covered by the benefit terms:

	2017	2016
Inactive employee or beneficiaries currently receiving benefits	2,942	2,888
Inactive employees entitled to but not yet receiving benefits	1,366	1,450
Active employees	2,617	2,668
	6,925	7,006

The Harris Health System Board of Trustees establishes the contribution requirements of the System based on an actuarially determined rate recommended by an independent actuary. The actuarially determined rate is the estimated amount necessary to finance the costs of benefits earned by employees during the year, with an additional amount to finance any unfunded accrued liability. For the year ended February 28, 2018, the System contributed $29.4 million or 17 percent of covered payroll. For the year ended February 28, 2017, the System contributed $32.7 million or 18 percent of covered payroll.

Net Pension Liability

The System's net pension liability was measured as of December 31, 2017 and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date.

Actuarial assumptions and methods used in the January 1, 2017 actuarial valuations are as follows.

	2017	2016
Valuation date	January 1, 2017	January 1, 2016
Measurement date	December 31, 2017	December 31, 2016
Actuarial cost method	Entry age normal	Entry age normal
Equivalent single amortization period	20 years, closed	20 years, closed
Asset valuation method	Market value	Market value
Actuarial assumptions:		
Inflation	3.0%	4.0%
Investment rate of return (net of expenses)	7.0	7.5
Projected salary increases (ultimate rate):		
Initial rate	5.1	6.8
Ultimate rate	3.0	4.0
Mortality rates:		
Healthy	RP-2014 Bottom Quartile Mortality Table, adjusted to 2006, with generational mortality improvement of Scale MP-2017	RP-2014 bottom quartile mortality tables with generational mortality improvement projected after 2014 with 50% of Scale MP-2014
Disabled	RP-2014 Disability Mortality Table, adjusted to 2006, with generational mortality improvement projected after year 2006 using Scale MP-2017 with generational mortality improvement of Scale MP-2017	RP-2014 Disability Mortality Rate

The long-term expected rate of return on pension plan investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. The target allocation and best estimates of arithmetic real rates of return as of December 31, 2017 for each major asset class are summarized in the following table.

Asset Class	Target Allocation		Long-term Expected Real Rate of Return
Real estate funds	5	%	7.30
Domestic equity-large cap	26		8.40
Domestic equity-small/mid cap	4		9.32
International equity	25		8.86
Fixed income	35		5.03
Hedge funds	5		10.87
	100	%	

The discount rate used to measure the total pension liability was 7.0 percent and 7.5 percent, net of expenses, as of December 31, 2017 and 2016, respectively. The projection of cash flows used to determine the discount rate assumed that System contributions would be made at rates equal to the actuarial determined contribution and the Plan's fiduciary net position is projected to cover benefit payments and administrative expenses.

Changes in the net pension liability are as follows (in thousands):

	Increase (Decrease)		
	Total Pension Liability (a)	Plan Fiduciary Net Position (b)	Net Pension Liability (a)-(b)
Balances at December 31, 2016	$ 828,711	$ 594,401	$ 234,310
Changes for the year:			
Service cost	6,803	-	6,803
Interest	61,427	-	61,427
Differences between expected and actual experience	1,718	-	1,718
Changes of assumptions	10,709	-	10,709
Contributions - employer	-	29,433	(29,433)
Net investment income	-	107,519	(107,519)
Benefit payments	(42,563)	(42,563)	-
Administrative expense	-	(2,478)	2,478
Net changes	38,094	91,911	(53,817)
Balance at December 31, 2017	$ 866,805	$ 686,312	$ 180,493

	Increase (Decrease)		
	Total Pension Liability (a)	Plan Fiduciary Net Position (b)	Net Pension Liability (a)-(b)
Balances at December 31, 2015	$ 806,323	$ 564,717	$ 241,606
Changes for the year:			
Service cost	7,232	-	7,232
Interest	59,397	-	59,397
Differences between expected and actual experience	(4,063)	-	(4,063)
Contributions - employer	-	32,693	(32,693)
Net investment income	-	39,529	(39,529)
Benefit payments	(40,178)	(40,178)	-
Administrative expense	-	(2,360)	2,360
Net changes	22,388	29,684	(7,296)
Balance at December 31, 2016	$ 828,711	$ 594,401	$ 234,310

Sensitivity of the net pension liability to changes in the discount rate – the following presents the net pension liability of the System, calculated using the discount rate of 7.0 percent, as well as what the System's net pension liability would be if it were calculated using a discount rate that is 1 percentage point lower (6.0 percent) or 1 percentage point higher (8.0 percent) than the current rate (in thousands):

	1% Decrease 6.0%	Current discount 7.0%	1% Increase 8.0%
System's net pension liability	$ 282,215	$ 180,493	$ 93,984

Pension Expense and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions

For the fiscal years ended February 28, 2018 and 2017, the System recognized pension expense of $27.9 million and $35.8 million, respectively. At February 28, 2018 and 2017, the System reported deferred outflows and deferred inflows of resources related to pension from the following sources (in thousands).

	2018	
	Deferred Outflows of Resources	Deferred Inflows of Resources
Changes of assumptions	$ 6,558	$ -
Differences between expected and actual experience	1,083	(1,031)
Net difference between projected and actual earnings on pension plan investments	-	(25,937)
Total	$ 7,641	$ (26,968)

	2017	
	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	$ 1,566	$ (2,547)
Net difference between projected and actual earnings on pension plan investments	33,933	-
Total	$ 35,499	$ (2,547)

Amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows (in thousands):

Year ended the last day of February:	
2019	$ 2,595
2020	1,572
2021	(11,276)
2022	(12,218)
	$ (19,327)

Deferred Compensation

The System 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 Deferred Compensation Plan, which is not recorded in the accompanying statements of net position, are not subject to creditors. The Deferred Compensation Plan assets at February 28, 2018 and 2017 were approximately $105.7 million and $94.0 million, respectively.

Post-employment Benefits Other than Pension

In addition to providing pension benefits, the System provides certain healthcare benefits for retired employees. The System's employees may become eligible for those benefits upon completing 10 years of service. The number of employees covered by the benefit terms as of March 1, 2017 included 2,055 retirees and 7,895 active employees. The number of employees covered by the benefit terms as of March 1, 2016 included 2,018 retirees and 7,280 active employees.

Retiree medical plan participants are provided benefits under the System's self-insured medical plan. The contribution requirements of plan members and the System are established by and may be amended by the System's Board of Trustees. For fiscal years 2018 and 2017, the System contributed $20 million and $19 million, respectively, to the Plan for current premiums and administrative costs. Plan members receiving benefits during fiscal years 2018 and 2017 contributed $3.7 million and $3.5 million, respectively, or approximately 19 percent and 18 percent, respectively, of the total premiums, through their required contribution of $75.83 per month and $79.92 per month for retiree-only coverage and $490.60 and $489.75 for retiree and spouse coverage.

The System's annual OPEB cost or expense is calculated based on the annual required contribution of the System (ARC), an amount actuarially determined in accordance with GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions*. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities, or funding excess, over a period not to exceed 30 years. The following table shows the components of the System's annual OPEB cost for the years 2018 and 2017, the amount actually contributed to the Plan, and changes in the System's net OPEB obligation to the Plan (in thousands):

	2018	2017
Annual required contribution	$ 58,191	$ 48,645
Interest on net OPEB obligation	10,528	9,339
Adjustment to annual required contribution	(10,958)	(9,720)
Annual OPEB cost/expense	57,761	48,264
Contributions	16,365	15,541
Increase in net OPEB obligation	41,396	32,723
Net OPEB obligation - beginning of year	268,442	235,719
Net OPEB obligation - end of year	$ 309,838	$ 268,442

The System's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for 2018 and 2017 were as follows (in thousands):

Fiscal Year	Annual OPEB Cost	Percentage of OPEB Contributed	Net OPEB Obligation
2018	$ 57,761	28%	$ 309,838
2017	48,264	32	268,442

As of the March 1, 2017 and 2016 actuarial valuations, the Plan was not prefunded. Contributions made were for current-year costs incurred only. The actuarially accrued liability for benefits was $703.0 and $609.2 million for March 1, 2017 and 2016, respectively, and the actuarial value of assets was $0 resulting in an unfunded actuarial accrued liability of $703.0 million and $609.2 million for March 1, 2017 and 2016, respectively. The covered payroll (annual payroll of active employees covered by the Plan) was $486.6 million and $437.8 million for March 1, 2017 and 2016, respectively. The ratio of the unfunded actuarial accrued liability to the covered payroll was 144.5 percent and 139.2 percent for March 1, 2017 and 2016, respectively.

Actuarial valuations of the Plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future, such as assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the annual required contributions of the System and the funded status of the Plan are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future.

In the March 1, 2017 and 2016 actuarial valuations, the entry age normal cost method and the projected unit credit actuarial cost method was used, respectively, and the actuarial assumptions included a 4.0 percent investment rate of return for both years. The 2017 actuarial valuation assumptions included an annual healthcare cost trend rate of 6.50 percent reduced by decrements to an ultimate rate of 4.75 percent after 5 years. The 2016 actuarial valuation assumptions included an annual healthcare cost trend rate of 6.75 percent reduced by decrements to an ultimate rate of 4.75 percent after 5 years. The initial unfunded actuarial liability was amortized over a period of 30 years based on a level percentage of payroll method.

Mortality rates for healthy pre-commencement and post- participants were based on RP-2014 bottom quartile mortality tables with generational projection using 50 percent of scale MP-2014. Rates for disabled participants were based on RP-2014 mortality tables for disabled retirees.

Note 10: Concentrations of Credit Risk

The System provides services to its patients, most of whom are local residents and may be 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 System's 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, 2018 and 2017 is as follows:

	2018	2017
Medicaid	16%	24%
Medicare	28%	23%
Commercial	21%	14%
Self-pay patient	35%	39%
	100%	100%

Note 11: Commitments and Contingencies

At February 28, 2018 and 2017, the System was a defendant in certain pending civil litigation and has notice of certain claims that have been asserted against it. The System is covered under the Texas Tort Claims Act (the Claims 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 other known and unknown incidents that have occurred through February 28, 2018, that may result in the assertion of additional claims. The System 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 System's management, the outcomes of these actions will not have a material adverse effect on the financial statements of the System.

The System has self-insurance programs for the payment of hospital professional and general liability claims, workers' compensation, and employee health claims. Liabilities related to these programs are accrued utilizing actuarial analyses based on historical claims experience and are undiscounted. Changes in these self-insurance programs for the years ended February 28, 2018 and 2017 are as follows (in thousands).

	Beginning-of-year Liability	Current-year Claims and Changes In Estimates	Claim Payments	End-of-year Liability
Hospital professional and general liability:				
2018	$ 1,230	$ 2,493	$ 2,054	$ 1,699
2017	1,275	2,136	2,181	1,230
Workers' compensation liability:				
2018	2,261	1,252	1,066	2,447
2017	2,365	1,168	1,272	2,261
Employee healthcare benefits liability:				
2018	10,096	103,720	103,725	10,091
2017	8,486	100,722	99,112	10,096

The reserve for hospital professional and general liability, including malpractice, and the reserve for workers' compensation claims are included in accounts payable and accrued liabilities in the accompanying statements of net position. The reserve for incurred but unreported employee health claims is included in employee compensation and related benefit liabilities in the accompanying statements of net position.

The System is also exposed to various risks of loss related to theft of, damage to, and destruction of assets, errors and omissions, and natural disasters. It is the System's policy to purchase commercial insurance for the risks of these losses. Settled claims have not exceeded this commercial coverage in any of the past three fiscal years.

At February 28, 2018, the System had commitments outstanding in the amount of approximately $8.9 million related to improvements at existing facilities and $3.9 million related to information technology projects.

At February 28, 2017, the System had commitments outstanding in the amount of approximately $16.2 million related to improvements at existing facilities and $5.0 million related to information technology projects.

The System had rental expenses related to its operating leases of approximately $11.7 million and $12.1 million during the years ended February 28, 2018 and 2017, respectively.

The System receives financial awards from federal and state agencies in the form of grants. Expenditures of funds under those programs require compliance with the grant agreements and are subject to audit. Any disallowed expenditures resulting from such audits become a liability of the System. In the opinion of management, such adjustments, if any, are not expected to materially affect the financial condition or operations of the System.

Note 12: Harris Collaborative Program

The Harris Collaborative Program is a collaborative established to improve the level of healthcare provided to the indigent population of Harris County by strategically allocating the available community healthcare resources and the burden of providing services. The parties to the collaborative include Harris Health System and the Affiliated Hospitals – Gulf Coast Division Inc., Memorial Hermann Hospital System, the Methodist Hospital, Texas Children's Hospital, Tomball Regional Medical Center, Park Plaza Hospital, Houston Northwest Medical Center, Cypress Fairbanks Medical Center, Pearland Medical Center and St. Luke's Episcopal Health System. An affiliation agreement among the parties allows the parties to improve access to healthcare for indigent persons residing in the Houston community through participation in one of the state's Medicaid supplemental payment programs for privately owned safety-net hospitals. The System provides funding for the nonfederal share of the Medicaid Supplemental Payment Program by using ad valorem tax revenues.

As part of the Harris collaboration, the Affiliated Hospitals formed a Certified Non-Profit Health Organization, Harris County Clinical Services Inc. (HCCS), to provide physician services to the indigent in the Harris County community. HCCS has an agreement with Affiliated Medical Services (AMS), a contracting entity for Baylor College of Medicine (Baylor) and the University of Texas Health Science Center (UT), which provides for Baylor and UT to supervise and direct services of patients of the System. With the creation of the collaborative, the agreement between AMS and HCCS was created in order to provide the physician services to indigent patients who seek treatment. In addition, HCCS also entered into agreements with other healthcare service providers to extend services available. Through its agreements with AMS and other providers, HCCS provides approximately $266 million of physician and other clinical services annually to the indigent in the Harris County community. Under a management agreement between HCCS and the System, the System manages the services provided by AMS and provides facilities for indigent patients to receive services.

During the fiscal years ended February 28, 2018 and 2017, the System utilized $180.4 million and $239.8 million of tax revenues, respectively, as the nonfederal share of the Harris Collaborative program. The System recorded expenses of $207.2 million and $194.4 million in 2018 and 2017, respectively, under the Harris Collaborative program and provider affiliation agreements. These expenses are reflected as physician services in the statements of revenues, expenses and changes in net position.

Required Supplementary Information

Harris County Hospital District,
d/b/a Harris Health System,
A Component Unit of Harris County, Texas
Schedule of Changes in the System's Net Pension Liability and Related Ratios
(Dollar amounts in thousands)

	Plan Year Ended December 31, 2017	2016	2015	2014
Total pension liability:				
Service cost	$ 6,803	$ 7,232	$ 7,795	$ 8,642
Interest	61,427	59,397	57,482	52,342
Difference between expected and actual experience	1,718	(4,063)	4,637	(1,909)
Changes of assumptions	10,709	-	-	40,689
Benefit payments	(42,563)	(40,178)	(44,023)	(34,444)
Net change in total pension liability	38,094	22,388	25,891	65,320
Total pension liability – beginning	828,711	806,323	780,432	715,112
Total pension liability – ending (a)	866,805	828,711	806,323	780,432
Plan fiduciary net position:				
Contributions – employer	29,433	32,693	31,759	31,292
Net investment income	107,519	37,401	(4,891)	37,069
Benefit payments	(42,563)	(40,178)	(44,023)	(34,444)
Administrative expense	(2,478)	(232)	(2,389)	(2,302)
Net change in plan fiduciary net position	91,911	29,684	(19,544)	31,615
Plan fiduciary net position – beginning	594,401	564,717	584,261	552,646
Plan fiduciary net position – ending (b)	686,312	594,401	564,717	584,261
System's net pension liability – ending (a) – (b)	$ 180,493	$ 234,310	$ 241,606	$ 196,171
Plan fiduciary net position as a percentage of the total pension liability	79.18%	71.70%	70.04%	74.86%
Covered payroll	$ 173,272	$ 182,060	$ 197,360	$ 210,728
System's net pension liability as a percentage of covered payroll	104.16%	128.68%	122.42%	93.09%

Notes to Schedule:

Changes of assumptions – In 2014, amounts reported as changes of assumptions resulted primarily from adjustments to assumed life expectancies as a result of adopting the RP-2014 bottom quartile mortality tables with generational mortality improvement projected after 2014 with 50% of Scale MP-2014 for purposes of developing mortality rates.

Changes of assumptions – In 2017, amounts reported as changes of assumptions resulted primarily from adjustments to assumed life expectancies as a result of adopting the MP-2017 scale and rate of return on investments from 7.5% to 7.0%.

Harris County Hospital District,
d/b/a Harris Health System,
A Component Unit of Harris County, Texas
Schedule of System Pension Contributions
January 1, 2018

	Plan Year Ended December 31,			
	2017	2016	2015	2014
Actuarially determined contribution	$ 29,433	$ 32,693	$ 31,759	$ 31,292
Contributions in relation to the actuarially determined contribution	29,433	32,693	31,759	31,292
Contribution deficiency (excess)	$ 0	$ 0	$ 0	$ 0
Covered payroll	$ 173,272	$ 182,060	$ 197,360	$ 210,728
Contributions as a percentage of covered payroll	17.00%	17.96%	16.09%	14.85%

Notes to Schedule:

Valuation date:

Actuarially determined contribution rates are calculated as of January 1, one year prior to the end of the fiscal year in which contributions are reported.

Methods and assumptions used to determine contribution rates:

Actuarial cost method	Entry age normal
Amortization method	Layered over a closed 20-year period
Remaining amortization period	17 years
Asset valuation method	Market value, 5-year smoothing
Inflation	3.0%
Salary increases	5.1% initial rate 3.0% ultimate rate
Investment rate of return	7.0%, net of pension plan investment expense, including inflation
Retirement age	Various – Expected retirement ages are adjusted to more closely reflect actual experience
Mortality	RP-2014 bottom quartile mortality tables with generational mortality improvement projected after 2006 with Scale MP-2017

Harris County Hospital District,
d/b/a Harris Health System,
A Component Unit of Harris County, Texas

Schedule of Funding Progress of Other Postemployment Benefit Plan

Three-Year Historical Trend Beginning March 1, 2015
(Dollar amounts in thousands)

Actuarial Valuation Date (1)	Actuarial Value of Assets (AVA) (2)	Actuarial Accrued Liability (AAL) (3)	Unfunded Actuarial Accrued Liability (UAAL) (3) – (2) (4)	Funded Ratio (2)/(3) (5)	Annual Covered Payroll (6)	UAAL as a Percentage of Covered Payroll (4)/(6)
March 1, 2015	$ -	$ 476,333	$ 476,333	$ -	$ 448,575	106.2%
March 1, 2016	-	609,222	609,222	-	437,747	139.2%
March 1, 2017	-	703,044	703,044	-	486,595	144.5%