HARRIS COUNTY HOSPITAL DISTRICT,
dba HARRIS HEALTH SYSTEM,
A COMPONENT UNIT OF HARRIS COUNTY, TEXAS

Financial Statements

February 29, 2016 and February 28, 2015

(With Independent Auditors' Report Thereon)

HARRIS COUNTY HOSPITAL DISTRICT,
dba HARRIS HEALTH SYSTEM,
A COMPONENT UNIT OF HARRIS COUNTY, TEXAS

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KPMG LLP
811 Main Street
Houston, TX 77002

Independent Auditors' Report

The Board of Managers
Harris County Hospital District, dba Harris Health System:

We have audited the accompanying financial statements of the business-type activities and the aggregate discretely presented component units of Harris County Hospital District, dba Harris Health System (the System), a component unit of Harris County, Texas, as of and for the years ended February 29, 2016 and February 28, 2015, and the related notes to the financial statements, which collectively comprise the System's basic financial statements as listed in the table of contents. We did not audit the financial statements of the Harris County Hospital District Foundation, a discretely presented component unit, which represent 14.2%, 24.2%, and 0.3% of the 2016 and 15.8%, 26.0%, and 0.8% of the 2015 assets, net position, and revenues of the aggregate discretely presented component units, respectively. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for the Harris County Hospital District Foundation, is based solely on the reports of the other auditor.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; 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.

Auditors' Responsibility

Our responsibility is to express opinions on these financial statements based on our audits. We conducted our audits 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 Harris County Hospital District Foundation and Community Health Choice, Inc. 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 auditors' 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 opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities and the aggregate discretely presented component units of Harris Health System, as of February 29, 2016 and February 28, 2015, and the respective changes in financial position, and cash flows thereof for the years then ended in accordance with U.S. generally accepted accounting principles.

Emphasis of Matter

As discussed in note 2(r) to the basic financial statements, effective March 1, 2015, the System adopted Governmental Accounting Standards Board (GASB) Statement No. 68, *Accounting and Financial Reporting for Pensions – An Amendment of GASB Statement No. 27* and GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date – An amendment to GASB Statement No. 68*. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

U.S. generally accepted accounting principles require that the management's discussion and analysis and supplementary schedules on pages 3–13 and 55–59, respectively, 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 20, 2016 on our consideration of the System's internal control over financial reporting and on 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 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.

KPMG LLP

Houston, Texas
June 20, 2016

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 29, 2016 and February 28, 2015. This section should be read in conjunction with the System's financial statements, which begin on page 14.

Financial Highlights

- The System's net position decreased approximately $197 million (28.0%) in fiscal 2016 due to the implementation of GASB Statement No. 68 and a corresponding reduction in beginning net position and $17 million (2.4%) in fiscal 2015.
- Total assets and deferred outflows increased approximately $6 million (0.4%) between fiscal 2015 and fiscal 2016. Total assets and deferred outflows decreased approximately $4 million (0.3%) between fiscal 2014 and fiscal 2015.
- Long-term debt, including current portion, decreased approximately $6 million (2.1%) in fiscal 2016 and $5 million (1.7%) in fiscal 2015. Other liabilities increased approximately $209 million (47.6%) in fiscal 2016 primarily due to an increase of $242 million in net pension liability related to the implementation of GASB Statement No. 68 and approximately $18 million (4.3%) in fiscal 2015 due to increased outstanding commitments related to postemployment health benefits.
- Community Health Choice, Inc. experienced a 13.2% growth in membership during fiscal 2016 and 10.2% growth in membership during fiscal 2015.
- The number of unduplicated patients served by the System increased 0.1% and 3.5% in fiscal 2016 and 2015, respectively. Services provided on an inpatient basis decreased 5.5% in fiscal 2016 versus an increase of 2.8% in inpatient services provided in fiscal 2015 as compared to 2014. Emergency care/urgent visits decreased 5.4% in fiscal 2016 versus an increase of 2.8% in fiscal 2015.
- Access to surgical services and appointment availability for primary care and specialty clinic visits has historically been a challenge. In fiscal 2014, the System began partnering with Federally Qualified Health Centers, outside physician groups, and surgical facilities to increase capacity. In fiscal 2015, the System opened eight additional clinics and three additional operating rooms. As a result, the System has experienced increases in primary care and specialty care visits provided, as well as surgery cases. With the addition of the incremental primary care capacity in 2015, access to appointments for primary care is no longer an issue for the System, and as a result the referral of primary care appointments to FQHCs has declined in fiscal 2016. The complete opening of the ambulatory surgery center and its five operating rooms at the LBJ campus

has allowed the System to curtail the outsourcing of surgery cases and handle most of the volume internally. In addition, the referred specialty visits associated with the outsourced surgical cases are no longer necessary.

	Fiscal 2016	Fiscal 2015	Percent change	Fiscal 2014	Percent change
Primary Care Visits	911,651	886,904	2.8%	806,615	10.0%
Referred Primary Care	1,769	6,140	(71.2)%	10,451	(41.2)%
Total	913,420	893,044	2.3%	817,066	9.3%
Specialty Care Visits	340,860	344,867	(1.2)%	335,570	2.8%
Referred Specialty Care	—	1,033	(100.0)%	308	235.4%
Total	340,860	345,900	(1.5)%	335,878	3.0%
Surgery Cases – Inpatient	12,091	11,472	5.4%	11,200	2.4%
Surgery Cases – Outpatient	12,320	10,593	16.3%	9,830	7.8%
Surgery Cases – Referred	286	1,646	(82.6)%	1,712	(3.9)%
Total	24,697	23,711	4.2%	22,742	4.3%

- During fiscal 2016 and 2015, the System invested $36 million and $44 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
  - Plant renovation and utility transition to Texas Medical Center sourced steam and chilled water
  - In fiscal 2015, the System completed most of the projects under a multi-year plan of space and facility expansion projects embarked on in 2008 including:
    - Eight outlying primary care clinic campuses in fiscal 2015 and one scheduled to open the first half of fiscal 2017
    - Three operating suites in fiscal 2015 and two in fiscal 2016 to complete the ambulatory surgery center at the LBJ campus.
- Capital Campaign contributions totaling $0.5 million were distributed to the System during both fiscal years 2016 and 2015 by the Harris County Hospital District Foundation.

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 and the HCHD Foundation (the Foundation) and Community Health Choice, Inc. (the HMO), 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 as 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)

	2016	2015	Dollar change	Total percentage change	2014	Dollar change	Total percentage change
Assets:							
Current and other assets	$ 924	942	(18)	(1.9)%	$ 945	(3)	(0.3)%
Capital assets	431	454	(23)	(5.1)%	467	(13)	(2.8)%
Total assets	1,355	1,396	(41)	(2.9)%	1,412	(16)	(1.1)%
Deferred outflows of resources:							
Derivative financial instrument	19	13	6	46.2%	—	13	100.0%
Resources related to pension	43	—	43	100.0%	—	—	0.0%
Unamortized loss on refunding debt	12	14	(2)	(14.3)%	15	(1)	(6.7)%
Total deferred outflows	74	27	47	174.1%	15	12	80.0%
Total assets and deferred outflows	$ 1,429	1,423	6	0.4%	$ 1,427	(4)	(0.3)%

Table 1

Condensed Statements of Net Position

(In millions)

	2016	2015	Dollar change	Total percentage change	2014	Dollar change	Total percentage change
Liabilities:							
Long-term debt outstanding	$ 275	281	(6)	(2.1)%	$ 286	(5)	(1.7)%
Other liabilities	648	439	209	47.6%	421	18	4.3%
Total liabilities	923	720	203	28.2%	707	13	1.8%
Deferred inflows of resources	—	—	—	0.0%	—	—	0.0%
Total liabilities and deferred inflows	$ 923	720	203	28.2%	$ 707	13	1.8%
Net investment in capital assets	$ 155	173	(18)	(10.4)%	$ 181	(8)	(4.4)%
Restricted	32	31	1	3.2%	31	—	0.0%
Unrestricted	319	499	(180)	(36.1)%	508	(9)	(1.8)%
Total net position	$ 506	703	(197)	(28.0)%	$ 720	(17)	(2.4)%

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 $197 million (28.0%) in fiscal 2016 and $17 million (2.4%) in fiscal 2015. The overall decrease in fiscal 2016 is the result of accounting changes related to the implementation of GASB Statement No. 68 requiring recognition of the pension plan sponsor’s entire net pension liability in the financials. The decrease in the fiscal 2015 is a result of the loss reported for the year.

Overall, total assets and deferred outflows of resources increased less than 1.0% from fiscal 2015 to 2016 and decreased less than 1.0% from fiscal 2014 to 2015.

- Current and other assets decreased 1.9% from fiscal 2015 to fiscal 2016 and 0.3% from fiscal 2014 to fiscal 2015.
- 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 of $43 million were recorded in fiscal 2016 related to the implementation of GASB Statement No. 68 accounting requirements. Deferred outflows related to hedging derivatives increased $6 million and $13 million in fiscal 2016 and 2015, respectively, with an offsetting change in derivative liability.

Total liabilities and deferred inflows of resources increased $203 million (28.2%) in fiscal 2016 and $13 million (1.8%) in fiscal 2015.

- In fiscal 2016 and 2015, reductions in bond-related debt reflect scheduled debt service payments.

- Other liabilities increased $209 million or 47.6% in fiscal 2016 primarily due to an increase of $242 million in net pension liability related to the implementation of GASB Statement No. 68.
- The System’s net obligation for the provision of certain post employment healthcare benefits increased approximately $22 million in both fiscal 2016 and fiscal 2015.
- Obligations under the Harris Collaborative Program were $54 million less at February 29, 2016 than February 28, 2015.
- The reported derivative liability associated with an interest rate swap increased $5.9 million at February 29, 2016 as compared to February 28, 2015.

In December of 2011, Texas received federal approval to redirect the upper payment limit program funding it would have received over the next five years into a new reform plan (1115 Waiver). The System had recorded receivables of $72.4 million and $219.9 million at February 29, 2016 and February 28, 2015, respectively, related to these Medicaid supplemental programs. Medicaid supplemental programs revenue recorded in fiscal 2016 included an unfavorable adjustment of $6.3 million for prior years’ programs. The February 2016 receivable includes $3.1 million and $69.3 million related to the 2011 and 2016 program years, 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 29, 2016, and February 28, 2015 and 2014, 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)

		2016	2015	2014
Operating revenues:				
Net patient service revenue	$	361,523	365,636	348,605
Medicaid supplemental programs revenues		180,639	235,758	255,894
Other operating revenues		36,745	28,490	23,130
Total operating revenues		578,907	629,884	627,629
Operating expenses:				
Salaries, wages, and benefits		699,514	710,047	707,335
Purchased services, supplies, and other		529,639	516,632	495,585
Depreciation and amortization		56,885	56,672	52,173
Total operating expenses		1,286,038	1,283,351	1,255,093
Operating loss	$	(707,131)	(653,467)	(627,464)

Table 2

Condensed Summary of Revenues, Expenses, and Changes in Net Position

(In thousands)

		2016	2015	2014
Nonoperating revenues:				
Ad valorem tax revenues – net	$	635,363	574,274	515,990
DSRIP		73,788	59,558	90,122
Tobacco settlement revenues		10,944	9,512	9,774
Investment income		2,151	5,010	876
Other		468	2,465	442
Total nonoperating revenues		722,714	650,819	617,204
Nonoperating expenses:				
Interest expense		(14,536)	(14,372)	(11,940)
Other		—	(42)	(6)
Total nonoperating expenses		(14,536)	(14,414)	(11,946)
Income (loss) before other revenues, expenses, gains, losses, and transfers		1,047	(17,062)	(22,206)
Capital contributions		—	—	—
Change in net position		1,047	(17,062)	(22,206)
Net position – beginning of year, as previously stated		703,096	720,158	742,364
Prior period adjustment		(198,351)	—	—
Net position – beginning of year, as restated		504,745	720,158	742,364
Net position – end of year	$	505,792	703,096	720,158

Revenues

During the year ended February 29, 2016, the System's total operating revenue decreased by $51 million (8.1%). Operating revenues increased $2.3 million (0.4%) during the year ended February 28, 2015.

- Net patient service revenue decreased $4 million in fiscal 2016 and increased $17 million in fiscal 2015 due to changes in service volumes and reimbursement from third party payors and patients.
- Estimated revenues from Medicaid supplemental programs decreased $55.1 million and $20.1 million in fiscal 2016 and 2015, respectively.

- Other operating revenues, including funding received under the Network Access Improvement Program (NAIP) and electronic health record incentive programs, increased $8.3 million in fiscal 2016 and increased $5.4 million in fiscal 2015 as compared to fiscal 2014.

Operating Expenses

During the year ended February 29, 2016, total operating expenses increased $2.6 million (0.2%).

- System salaries and wages decreased $19.3 million (3.6%) as a result of decreases in staffing, approximately 3.5%.
- Related benefits increased $8.7 million (4.8%) due to increases in employee medical plan costs and also employee retirement plan costs.
- Purchased medical services, supplies, and other operating expenses increased 2.5%, primarily as a result of increased costs for physician services.

During the year ended February 28, 2015, total operating expenses increased $28.3 million (2.3%).

- System salaries and wages increased $6.3 million (1.2%). The compensation plan remained competitive with merit increases and an average salary decrease of 1.2%. Total staffing increased 2.5% with a productivity improvement of 2.0%.
- Related benefits decreased $3.6 million (2.0%) due to decreases in employee retirement plan costs and employee medical plan costs.
- Purchased medical services, supplies, and other operating expenses increased 4.3%, primarily as a result of increased service volumes, costs incurred under the Harris Collaborative Program, and costs for pharmaceuticals.

Overall, the System's operating loss increased 8.2% from 2015 to 2016 and increased 4.1% from 2014 to 2015 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, 1115 Waiver delivery system reform incentive payment program (DSRIP), interest expense, gains or losses on disposal of assets, and certain grants and donations. Tax revenues, net of related expenses, increased $61.1 million, or 10.6%, in fiscal 2016 and $58.3 million in fiscal 2015, or 11.3%. Investment income decreased $2.9 million in fiscal 2016 compared to an increase of $4.1 million reported for fiscal 2015. The System received approximately $10.9 million and $9.5 million in tobacco settlement revenue in fiscal year 2016 and 2015, respectively. Nonoperating grants and donations and gains/losses on disposal of assets totaled $0.5 million in fiscal 2016 compared to $2.5 million in fiscal 2015. The System received $73.8 million in fiscal 2016 and $59.6 million in fiscal 2015 under the DSRIP.

(Continued)

Capital Assets and Debt Financing

During fiscal 2016 and 2015, the System invested $36 million and $44 million, respectively, in information technology, equipment, and facility expansion and renovation. Table 3 summarizes the changes in the System's capital assets between February 29, 2016 and February 28, 2014:

Table 3

Changes in Capital Assets

(In thousands)

	2016	2015	Dollar change	Total percentage change	2014	Dollar change	Total percentage change
Land and improvements	$ 41,792	41,468	324	0.8%	$ 41,059	409	1.0%
Buildings and fixed equipment	606,667	590,801	15,866	2.7%	566,189	24,612	4.3%
Major movable equipment	338,486	340,820	(2,334)	(0.7)%	334,804	6,016	1.8%
Subtotal	986,945	973,089	13,856	1.4%	942,052	31,037	3.3%
Less accumulated depreciation	(575,483)	(540,584)	(34,899)	6.5%	(507,000)	(33,584)	6.6%
Construction in progress	20,015	21,599	(1,584)	(7.3)%	31,652	(10,053)	(31.8)%
Capital assets – net	$ 431,477	454,104	(22,627)	(5.0)%	$ 466,704	(12,600)	(2.7)%

In 2008, the System embarked on a multi-year plan in capital projects for the expansion of existing diagnostic and treatment facilities to improve access to healthcare services. Most of these projects were completed in fiscal 2015.

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 2017 includes an investment of $60.1 million in routine capital expenditures. The capital projects include $15.5 million in information technology primarily dedicated to current system upgrades and technology refresh, $18.1 million specific to medical capital, and $26.5 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. Separate funding is to be provided for the project currently estimated at $70 million.

(Continued)

At February 29, 2016 and February 28, 2015, the System had $275.2 million and $280.7 million, respectively, in outstanding revenue bonds. In October 2007, the System issued Series 2007A refunding and revenue bonds to refund $24 million in outstanding commercial paper debt, to provide funding for expansion and renovation projects totaling $158 million and to fund the required debt service reserve fund. In October 2007, the System also refunded and refinanced the Series 2000 revenue bonds with the issuance of Series 2007B Bonds in the amount of $103.5 million. The bonds were initially issued as 28-day taxable auction-rate paper converting to tax exempt in August of 2010. Subsequent to the 2008 fiscal year-end, the auction-rate paper was converted to taxable fixed rate 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 Series 2010 Bonds financed the refunding of the 2007B Bonds and costs of issuance and are tax exempt. The Series B Bonds were hedged with a forward starting swap effective upon the tax-exempt conversion of the Bonds. In order to obtain a substantially fixed rate for the 2007B debt service requirements, a Qualified Hedge Agreement was executed between the Harris County Hospital District and Siebert Brandford Shank & Co. and the Harris County Hospital District and Bank of America. In fiscal 2014, the agreement was assigned and assumed by Deutsche Bank as the credit support provider for Siebert Brandford Shank & Co. The swap became effective August 16, 2010 upon issuance of the Series 2010 Refunding Bonds. On that date, the interest rate swap was redesignated to the new debt and an off market element totaling $17,546,000 to the swap was created. In accordance with Governmental Accounting Standards Board (GASB) Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, this off-market element is recorded as a borrowing payable and is being amortized as an adjustment to interest expense over the life of the swap agreement. The 2007B Bonds were defeased through the irrevocable deposit of sufficient funds with trustees to pay the principal and interest of such bonds through maturity. Moody's and Standard & 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 Managers and the Harris County Commissioners' Court. Table 4 below summarizes the System's debt obligations at February 29, 2016, and February 28, 2015 and 2014:

Table 4

Long-Term Debt and Other Long-Term Obligations

(In thousands)

		2016	2015	2014
Series 2007 tax-exempt revenue bonds	$	181,320	184,655	187,830
Series 2010 revenue bonds		93,925	96,005	98,025
Borrowing payable – interest rate swap		12,742	13,571	14,417
Derivative liability		18,949	13,040	271
Other long – term obligations		246	623	845
Total long-term debt and other long-term obligations		307,182	307,894	301,388
Less current portion		(5,686)	(5,599)	(5,445)
Noncurrent portion	$	301,496	302,295	295,943

The System's long-term debt and short-term debt ratings at February 29, 2016 and February 28, 2015 were "AA" and "F1".

Economic Conditions and Plan for Fiscal 2017

In planning for fiscal 2017, 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. Issues that need to be monitored on an ongoing basis throughout the year include the following:

- Continuing growth in Harris County, the demand for services by the uninsured population, and the capacity of the System at both a physical plant capacity level and staffing availability level
- Clinical throughput, including inpatient and outpatient surgical capabilities
- Timely progress on the Ben Taub Trauma Center project for maintenance of Level I certification
- Current and future funding available under the Medicaid Supplemental programs and resulting significant cash flow fluctuations
- Property tax funding and the valuation of properties within Harris County
- Increased cost of maintaining existing services and efforts to reduce expenses
- Routine plant and equipment needs for replacement of aged equipment and needed repairs, maintenance, and renovation
- Cost savings and efficiencies available under the Harris County Collaborative and the new Texas 1115 Waiver Program or DSRIP
- Advancement in the System's key strategic priorities of:
  - Meeting community needs through improved access to care,
  - Providing high-quality healthcare,
  - Improving patient, physician, and employee satisfaction,
  - Hiring and retaining excellent employees, and
  - Positioning the System to succeed in an evolving healthcare reform environment
- Maintenance of financial strength and stable cash positions.

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,
dba HARRIS HEALTH SYSTEM,
A COMPONENT UNIT OF HARRIS COUNTY, TEXAS

Statements of Net Position

February 29, 2016 and February 28, 2015

(In thousands)

	2016			2015		
		Component units			Component units	
Assets and Deferred Outflows of Resources	**Harris Health System**	**Foundation**	**Community Health Choice Inc.**	**Harris Health System**	**Foundation**	**Community Health Choice Inc.**
Current assets:						
Cash and cash equivalents	$ 201,260	1,817	70,175	160,319	778	28,883
Short-term investments (notes 5 and 6)	289,859		68,139	347,367	—	101,516
Accounts receivable – net of allowance for uncollectible						—
accounts of $131,170 and $98,083 (note 10)	63,836	—	—	76,653	—	—
Current portion of ad valorem taxes receivable – net of						
allowance for uncollectible taxes of $6,436 and $5,760	29,006	—	—	26,288	—	—
Inventories	9,721	—	—	12,458	—	—
Medicaid supplemental programs receivable	72,368	—	—	219,851	—	—
Prepaid expenses and other current assets	11,084	619	26,889	12,382	783	17,035
Estimated third-party payor settlements	805	—	—	2,553	—	—
Due from Community Health Choice, Inc.	6,738	—	—	4,746	—	—
Current portion of assets limited as to use or restricted						
(notes 5 and 6)	6,266	—	—	6,041	—	—
Total current assets	690,943	2,436	165,203	868,658	1,561	147,434
Assets limited as to use or restricted – net of current portion						
(notes 5 and 6):						
Debt service	24,882	—	—	24,709	—	—
Other	821	20,924	—	822	23,104	—
Total assets limited as to use or restricted – net	25,703	20,924	—	25,531	23,104	—
Capital assets (notes 7 and 11):						
Land and improvements	41,792	—	—	41,468	—	—
Buildings and fixed equipment	606,667	—	—	590,801	—	—
Major movable equipment	338,486	—	—	340,820	—	—
Less accumulated depreciation	(575,483)	—	—	(540,584)	—	—
Total depreciable capital assets – net	411,462	—	—	432,505	—	—
Construction in progress	20,015	—	—	21,599	—	—
Capital assets – net	431,477	—	—	454,104	—	—
Other assets:						
Ad valorem taxes receivable – net of current portion and						
allowance for uncollectible taxes of $38,066						
and $41,325	284	—	—	313	—	—
Net pension asset (note 9)	—	—	—	2,180	—	—
Long-term investments (note 6)	205,413		79,758	43,957	—	47,465
Prepaid debt insurance	1,377	—	—	1,463	—	—
Other assets	70	11,437	—	70	11,824	—
Total other assets	207,144	11,437	79,758	47,983	11,824	47,465
Deferred outflows of resources:						
Derivative financial instrument	18,949	—	—	13,040	—	—
Resources related to pension	43,318	—	—	—	—	—
Loss on Series 2010 Refunding Revenue Bonds	11,786	—	—	13,480	—	—
Total deferred outflows of resources	74,053	—	—	26,520	—	—
Total assets and deferred outflows of resources	$ 1,429,320	34,797	244,961	1,422,796	36,489	194,899

HARRIS COUNTY HOSPITAL DISTRICT,
dba HARRIS HEALTH SYSTEM,
A COMPONENT UNIT OF HARRIS COUNTY, TEXAS

Statements of Net Position

February 29, 2016 and February 28, 2015

(In thousands)

Liabilities, Deferred Inflows of Resources, and Net Position	**2016** Harris Health System	**2016** Component units: Foundation	**2016** Component units: Community Health Choice, Inc.	**2015** Harris Health System	**2015** Component units: Foundation	**2015** Component units: Community Health Choice, Inc.
Current liabilities:						
Accounts payable and accrued liabilities	$ 71,205	265	45,170	121,517	207	13,577
Interest payable	631	—	—	628	—	—
Employee compensation and related benefit liabilities (note 11)	23,365	—	—	26,789	—	—
Post employment health benefit liability (note 9)	15,433	—	—	15,738	—	—
Compensated absences	37,250	—	—	39,977	—	—
Medical claims liability (note 2)	—	—	85,138	—	—	72,227
Due to Harris Health System	—	—	6,481	—	—	5,851
Estimated third-party payor settlements	6,570	—	—	9,498	—	—
Current portion of long-term debt and capital leases (note 8)	5,686	—	—	5,599	—	—
Total current liabilities	160,140	265	136,789	219,746	207	91,655
Other long-term liabilities:						
Postemployment health benefit liability (note 9)	220,286	—	—	197,659	—	—
Net pension liability (note 9)	241,606	—	—	—	—	—
Borrowing payable (note 8)	12,742	—	—	13,571	—	—
Derivative liability	18,949	—	—	13,040	—	—
Other	42	—	—	151	—	—
Long-term debt (note 8):						
Series 2007 revenue bonds	177,820	—	—	181,320	—	—
Series 2010 refunding revenue bonds	91,790	—	—	93,925	—	—
Other long-term obligations – capital leases	153	—	—	288	—	—
Total liabilities	923,528	265	136,789	719,700	207	91,655
Deferred inflows of resources	—	—	—	—	—	—
Commitments and contingencies (note 11)						
Net position:						
Net investment in capital assets	155,072	—	—	172,900	—	—
Restricted for debt service	31,970	—	—	31,572	—	—
Restricted – other	—	25,701	—	—	27,281	—
Unrestricted	318,750	8,831	108,172	498,624	9,001	103,244
Total net position	505,792	34,532	108,172	703,096	36,282	103,244
Total liabilities, deferred inflows of resources, and net position	$ 1,429,320	34,797	244,961	1,422,796	36,489	194,899

See accompanying notes to financial statements.

HARRIS COUNTY HOSPITAL DISTRICT,
dba HARRIS HEALTH SYSTEM,
A COMPONENT UNIT OF HARRIS COUNTY, TEXAS

Statements of Revenues, Expenses, and Changes in Net Position

Years ended February 29, 2016 an February 28, 2015

(In thousands)

	2016			2015		
		Component units			Component units	
	Harris Health System	Foundation	Community Health Choice, Inc.	Harris Health System	Foundation	Community Health Choice, Inc.
Operating revenues:						
Net patient service revenue (note 3)	$ 361,523	—	—	365,636	—	—
Medicaid supplemental programs revenue (note 4)	180,639	—	—	235,758	—	—
Premium revenue	—	—	891,024	—	—	725,928
Other operating revenues	36,745	2,291	81	28,490	1,968	173
Total operating revenues	578,907	2,291	891,105	629,884	1,968	726,101
Operating expenses:						
Salaries, wages, and benefits	699,514	487	38,125	710,047	665	32,812
Pharmaceuticals and supplies	207,422	4	2,131	211,840	15	1,727
Physician services (note 12)	210,490	—	—	192,966	—	—
Medical claims expense	—	—	803,304	—	—	644,120
Other purchased services	111,727	3,269	42,840	111,826	2,956	32,049
Depreciation and amortization	56,885	—	—	56,672	—	—
Total operating expenses	1,286,038	3,760	886,400	1,283,351	3,636	710,708
Operating (loss) income	(707,131)	(1,469)	4,705	(653,467)	(1,668)	15,393
Nonoperating revenues (expenses):						
Ad valorem tax revenues – net	635,363	—	—	574,274	—	—
DSRIP	73,788	—	—	59,558	—	—
Tobacco settlement revenues	10,944	—	—	9,512	—	—
Investment income (loss)	2,151	(95)	881	5,010	3,625	1,160
Interest expense (note 8)	(14,536)	—	—	(14,372)	—	—
Other	468	(186)	(658)	2,423	(170)	(3,500)
Total nonoperating revenues (expenses) – net	708,178	(281)	223	636,405	3,455	(2,340)
Changes in net position	1,047	(1,750)	4,928	(17,062)	1,787	13,053
Net position – beginning of year, as previously stated	703,096	36,282	103,244	720,158	34,495	90,191
Prior period adjustment (note 2(s))	(198,351)	—	—	—	—	—
Net position – beginning of year, as restated	504,745	36,282	103,244	720,158	34,495	90,191
Net position – end of year	$ 505,792	34,532	108,172	703,096	36,282	103,244

See accompanying notes to financial statements.

HARRIS COUNTY HOSPITAL DISTRICT,
dba HARRIS HEALTH SYSTEM,
A COMPONENT UNIT OF HARRIS COUNTY, TEXAS

Statements of Cash Flows

Years ended February 29, 2016 and February 28, 2015

(In thousands)

		2016 Harris Health System	2015 Harris Health System
Operating activities:			
Receipts from and on behalf of patients	$	376,198	379,660
Receipts from Medicaid supplemental programs		328,122	259,444
Receipts from incentive programs and grants		19,092	11,883
Receipts from other revenues		11,663	11,527
Payments to suppliers		(582,580)	(528,486)
Payments to employees and for employee benefits		(681,226)	(688,340)
Net cash used in operating activities		(528,731)	(554,312)
Noncapital financing activities:			
Contributions – net		503	2,500
Ad valorem taxes – net		632,660	573,837
DSRIP revenues		73,788	59,558
Tobacco settlement revenues		10,944	9,512
Net cash provided by noncapital financing activities		717,895	645,407
Capital and related financing activities:			
Acquisitions and construction of capital assets		(27,502)	(56,921)
Interest paid		(13,777)	(13,837)
Repayment of long-term debt		(5,530)	(5,417)
Net cash used in capital and related financing activities		(46,809)	(76,175)
Investing activities:			
Receipts of investment income – including realized gains and losses		3,136	3,076
(Increase) decrease in cash equivalents included in assets limited as to use or restricted		(739)	10,103
Purchases of investment securities		(775,940)	(611,576)
Proceeds from sale and maturities of investment securities		672,129	570,080
Net cash used in investing activities		(101,414)	(28,317)
Net increase (decrease) in cash and cash equivalents		40,941	(13,397)
Cash and cash equivalents – beginning of year		160,319	173,716
Cash and cash equivalents – end of year	$	201,260	160,319

(Continued)

HARRIS COUNTY HOSPITAL DISTRICT,
dba HARRIS HEALTH SYSTEM,
A COMPONENT UNIT OF HARRIS COUNTY, TEXAS

Statements of Cash Flows

Years ended February 29, 2016 and February 28, 2015

(In thousands)

		2016 Harris Health System	2015 Harris Health System
Reconciliation of operating loss to net cash used in operating activities:			
Operating loss	$	(707,131)	(653,467)
Adjustments to reconcile operating loss to net cash used in operating activities:			
Depreciation and amortization		56,885	56,672
Changes in operating assets and liabilities:			
Decrease in accounts receivable		12,817	3,551
Decrease (increase) in inventories		2,737	(2,256)
Decrease in Medicaid supplemental programs receivable		147,483	23,686
Increase in prepaid expenses and other assets		(3,283)	(1,200)
Decrease in estimated third-party payor settlements		1,748	1,204
Decrease in net pension asset		—	51
Decrease in accounts payable and accrued liabilities		(55,347)	(10,321)
Increase in net pension liability		2,117	—
(Decrease) increase in employee compensation and related benefit liabilities		(3,424)	1,171
Decrease in compensated absences		(2,727)	(1,070)
(Decrease) increase in estimated third-party payor settlements		(2,928)	6,112
Increase in postemployment health benefit liability		22,322	21,555
Total adjustments		178,400	99,155
Net cash used in operating activities	$	(528,731)	(554,312)
Supplemental disclosures of noncash operating, financing, and investing activities:			
Unrealized gain on investments	$	1,221	1,426
Amounts related to acquisition of capital assets in accounts payable and accrued liabilities		12,057	7,022
Amount of interest expense capitalized		—	355

See accompanying notes to financial statements.

(1) Organization and Mission

Harris County Hospital District, dba 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 963 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, 6 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: Ruth E. Ransom, Executive Director (Ruth.Ransom@harrishealth.org).

Community Health Choice, Inc. (the HMO), is a Texas not-for-profit corporation incorporated on May 8, 1996, and organized under Section 501 (c)(4) of the Internal Revenue Code to operate as a health maintenance organization. The HMO was licensed by the Texas Department of Insurance on February 14, 1997. The HMO offers individual health insurance on the Health Insurance Marketplace and 3 Medicaid insurance products and had approximately 294,633 and 260,236 enrollees as of December 31, 2015 and 2014, respectively. The HMO is reported as a discretely presented component unit of the System since the HMO’s Board of Directors is appointed by the System’s Board of Managers and the System can impose its will on the HMO. The differences in amounts due to the System and due from the HMO in the accompanying statements of net position are primarily due to the presentation of the HMO’s financials based on its fiscal

(Continued)

year-end of December 31. Financial reports for the HMO can be obtained from Community Health Choice, 2636 South Loop West, Ste. 700, Houston, Texas 77054. Attention: Richard Lee, Senior Vice President Finance (Richard.Lee@CommunityCares.com).

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

(2) Summary of Significant Accounting Policies

(a) Basis of Accounting

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

(b) 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 flow.

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 HMO is licensed only in the state of Texas and reports under Financial Accounting Standards Board pronouncements. The HMO's financial statement formats were modified to make them compatible with the System's financial statement formats.

(c) Principles of Reporting

The financial statements include the accounts of the System, the Foundation, and the HMO, 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 HMO 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 HMO including employment of all individuals who perform the day-to-day requirements of the business functions of the HMO. The HMO reimburses the System for such salaries, wages, and benefits and these costs are reflected as expenses of the HMO. An additional fee for indirect costs approximating $1,298,000 and $996,000 for fiscal years 2016 and 2015, 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 HMO's Board of Directors has 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 HMO's 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, approximately $555,000 and $774,000 in fiscal years 2016 and 2015, 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 $1,152,000 and $1,342,000 in 2016 and 2015, respectively. In addition, the Foundation distributed to the System contributions totaling $505,000 and $542,000 in 2016 and 2015, respectively, from its multi-year Capital Campaign funds.

(d) 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. Short-term investments are investments with maturities in excess of three months, but less than a year, when purchased.

The System's and HMO's cash, cash equivalents, and short-term investments are invested in fully collateralized time deposits, certificates of deposit, and government securities as authorized by Chapter 281 of the *Texas Health and Safety Codes* and Chapter 116 of the *Texas Local Government Code*. Such total collateralization and insurance coverage is required by the Board of Managers 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.

(e) 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.

(f) Inventories

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

(g) Capital Assets

Property, plant, and equipment are carried at cost or fair market value at the time of donation and include expenditures for new facilities and equipment and expenditures that substantially increase the useful life of existing 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 assets.

(h) Deferred Bond Issue Costs

The portion of debt issuance costs related to prepaid insurance costs is reported as an asset and amortized over the term of the respective bond issue using the bonds outstanding method.

(i) 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% or at the time of termination, unused benefits are payable at 75%. Changes in the System's liability for compensated absences in fiscal years 2016 and 2015 are as follows (in thousands):

Fiscal year		Beginning-of-year liability	Current-year claims and changes in estimates	Claim payments	End-of-year liability
2016	$	39,977	60,217	62,944	37,250
2015		41,047	58,850	59,920	39,977

(j) 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.

(k) 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 collectibility 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 $131,170,000 and $98,083,000 as of February 29, 2016 and February 28, 2015, 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 $3.9 million during 2016 and a decrease of $6.6 million during 2015, respectively, from the differences between estimated and actual cost report settlements and appeals.

(l) 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 29, 2016 and February 28, 2015.

	2016	2015
Charges foregone, based on established rates	$ 1,547,834,000	1,523,549,000
Cost of foregone charges, estimated	613,056,000	591,972,000

(m) Premium Revenue

Premium revenue is recognized as revenue during the coverage period of the subscriber agreement. For its primary Medicaid business, the HMO is notified 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 HMO believes that it has appropriately recognized premium revenue for the years ended December 31, 2015 and 2014.

(n) Medical Claims Expense

The HMO arranges for comprehensive healthcare services to its members primarily through fee-for-service arrangements. The HMO compensates 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.

(Continued)

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, 2015, the HMO recognized a premium deficiency reserve in the amount of $6,589,000 for the new Health Insurance Marketplace business. As of December 31, 2014, the HMO recognized a premium deficiency reserve in the amount of $3,928,000 for the new Health Insurance Marketplace business.

Changes in the HMO's aggregate liability for medical claims and the premium deficiency reserve in fiscal years 2016 and 2015 are as follows (in thousands):

Fiscal year		Beginning of fiscal year liability	Medical claims and changes in estimates	Claim payments	Current-year premium deficiency reserve	End of fiscal year liability
2016	$	72,227	738,677	732,355	6,589	85,138
2015		62,430	640,824	634,955	3,928	72,227

In fiscal year 2016, the HMO paid $675.1 million in claims related to the current fiscal year and $57.3 million in claims related to the prior fiscal year. In fiscal year 2015, the HMO paid $571.6 million in claims related to the current fiscal year and $63.3 million in claims related to the prior fiscal year.

The HMO is a party to a reinsurance agreement to limit its losses on individual claims. Under the terms of the agreement, the reinsurer reimburses the HMO approximately 90%, subject to certain limitations as specified in the contract, of the cost of each member's annual inpatient hospital services. For the HMO's Medicaid and CHIP business, the HMO's recovery is based on costs in excess of a $1,000,000 deductible, up to a limitation of $1,000,000 per member per agreement period. The HMO also carries coverage for its Healthcare Insurance Marketplace (HIM) business for which the reinsurer reimburses the HMO approximately 90% of each member's annual inpatient hospital services in excess of a $400,000 deductible, up to a limitation of $1,000,000 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 nongrandfathered reinsurance-eligible individual market plans, the administrative costs of operating the reinsurance program, and the General Fund of the U.S. Treasury for the 2015 and 2016 benefit years. Coverage is provided through the Center for Medicare & Medicaid Services (CMS) and will reimburse the HMO approximately 80% of the cost of each marketplace member's annual medical services for which cumulative paid claims are between $25 and $400 thousand dollars.

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

Community Health Choice, Inc. participates in the federally facilitated health insurance exchange in nine 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 Company 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 Company recognizes 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 2015, the Company recognized $83,619,084 and $21,586,566 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 Company's expense related to this required funding is recognized as a reduction of premium revenue. When annual claim costs incurred by our individual members exceed a specified retention level, the Company is entitled to certain reimbursements from this program. The Company's estimated recoveries are recorded as a receivable and a reduction to medical costs for the policy year involved. As of December 31, 2015 and 2014, the Company accrued $5,923,931 and $510,360, 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 Company 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 Company records 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, 2015, the Company did not recorded a payable or receivable for the risk corridor program. At December 31, 2014, the company recorded a risk corridor receivable of $632,172.

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 our members relative to the average risk of members of other qualified plans in comparable markets, the Company estimates the ultimate risk adjustment receivable or payable and records the year-to-date impact as an adjustment to premium revenue. At December 31, 2015 the Company recorded a risk adjustment payable of $30,243,179. The payable was estimated based on the Texas statewide results from the 2014 CMS Risk Adjustment calculation, projected forward to 2015, which are then combined with the Company's 2015 actual preliminary results of allowable premium revenue, claims, risk scores, and metallic level membership composition. At

December 31, 2014, the Company did not recorded any risk adjustment due to the lack of a reasonable methodology to extrapolate risk scores based on our very limited experience in the commercial health insurance market

(p) 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.

(q) Tobacco Settlement Revenues

In the fiscal years ended February 29, 2016 and February 28, 2015, 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 received.

(r) 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.

(s) Newly Adopted Accounting Pronouncements

GASB Statement No. 68 – GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*, an amendment of GASB Statement No. 27. The Statement's objective is to improve accounting and financial reporting by pension plan sponsors. The Statement requires recognition of the entire net pension liability and a more comprehensive measure of pension expense and new footnote disclosures and required supplementary information. The Statement is effective for financial statements prepared by state and local governments for periods beginning after June 15, 2014. All applicable provisions have been included in the System's financial statements as of fiscal year 2016. The adoption of the Statement resulted in the recognition of an additional $196.1 million in net pension liability, a decrease of $2.2 million in net pension asset, and a corresponding net reduction in unrestricted net position of $198.3 million.

GASB Statement No. 71 – GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date*, an amendment of GASB Statement No. 68. The Statement is

(Continued)

required to be applied simultaneously with the provisions of Statement No. 68, which is effective for financial statements for periods beginning after June 15, 2014. All applicable provisions have been included in the System's financial statements as of fiscal year 2016.

Pending Adoption of Recent Accounting Pronouncements

GASB Statement No. 72 – GASB Statement No. 72, *Fair Value Measurement and Application*. The Statement provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements. The Statement requires donated capital assets be measured at acquisition value versus the previous requirement of measurement at fair value. The requirements of this Statement are effective for financial statements for reporting periods beginning after June 15, 2015.

GASB Statement No. 73 – GASB Statement No. 73, *Accounting and Financial Reporting for Pensions and related Assets That Are Not within the Scope of GASB Statement 68,* and Amendments to Certain Provision of GASB Statements 67 and 68. The objective of the Statement is to improve the usefulness of information about pensions included in the general purpose external financial reports of state and local governments for making decisions and assessing accountability. The requirements of this Statement are effective for financial statements for reporting periods beginning after June 15, 2015.

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.

GASB Statement No. 75 – The System has not completed the process of evaluating the impact that will result from implementing 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 GASB effective for employer fiscal years beginning after June 15, 2017.

GASB Statement No. 76 – GASB Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*. The objective of this Statement is to improve financial reporting by raising the category of GASB Implementation Guides in the hierarchy of generally accepted accounting principles used to prepare financial statements of state and local governmental entities. The requirements of the Statement are effective for fiscal years beginning after June 15, 2015.

GASB Statement No. 77 – GASB Statement No. 77, *Tax Abatement Disclosures*. The objective of the statement is to improve financial reporting by requiring disclosure of information about the nature and magnitude of tax abatements that will make the transactions more transparent and assist the user in understanding the impact of the abatements on the government's financial position and economic condition and how they affect a government's future ability to raise resources and meet its financial obligations. The requirements of the Statement are effective for financial statements for periods beginning after December 15, 2015.

GASB Statement No. 78 – GASB Statement No. 78, *Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans*. This Statement amends the scope and applicability of Statement 68 to exclude pensions provided through certain cost-sharing multiple-employer defined benefit pension plans. The Statement is effective for periods beginning after December 15, 2015. At this time, the System has determined that the Statement is not applicable.

GASB Statement No. 79 – GASB Statement No. 79, *Certain External Investment Pools and Pool Participants*. This Statement establishes accounting and financial reporting standards for state and local governments that participate in certain external investment pools. The Statement is effective for periods beginning after June 15, 2015. 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.

(t) 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.

(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 beneficiaries are reimbursed under a cost reimbursement methodology. For outpatients, the System is reimbursed a preliminary rate, with final settlement determined after submission of annual cost reports by the System and reviews thereof by the Medicaid administrative contractor based on Medicare administrative contractor audits. The System's Medicaid cost reports have been settled by the Medicaid administrative contractor through February 28, 2010.

Cash received from the Medicare program accounted for approximately 29% and 32% of the System's total cash collections for net patient service revenue for years ended February 29, 2016 and February 28, 2015. Cash received from the Medicaid program (including managed Medicaid) accounted for approximately 50% and 49% of the System's total cash collections for net patient service revenue for the years ended February 29, 2016 and February 28, 2015.

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.

(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% 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 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.

The System recognizes all funds received under the DSH and UC programs as operating revenues in the period applicable to the funds. Any amounts related to that year that are not received as of fiscal year-end are recorded as receivables and reflected in other current assets in the accompanying statements of net position. These receivables can be subject to adjustments that are reflected in the period they become known. The System recorded an unfavorable adjustment of $6.3 million and $0.3 million in fiscal year 2016 and 2015 for prior years programs, respectively. The System has recorded a receivable of $72.4 and $219.9 million at February 29, 2016 and February 28, 2015, respectively, related to the DSH and UC programs.

The System recognizes all funds received under the DSRIP program as nonoperating revenues in the period of qualification, based on achievement of defined goals, as determined.

(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 2007 and 2010 bond issues (50% of the greatest debt service requirement scheduled to occur); funds restricted by donors; or funds designated by the board for future debt service, future capital expansion, and other uses. Investments in government securities are recorded at fair value. The carrying amount of money market government funds approximates fair value. The fair values of securities are based on quoted market prices as of February 29, 2016 and February 28, 2015. The components of assets limited as to use or restricted at fair value at February 29, 2016 and February 28, 2015, are as follows (in thousands):

		2016		
Description of assets		**Total**	**Restricted debt service**	**Other**
Money market government funds	$	986	742	244
Commercial paper		5,554	4,977	577
Government securities		25,429	25,429	—
		31,969	31,148	821
Less funds required for current liabilities		(6,266)	(6,266)	—
	$	25,703	24,882	821

		2015		
Description of assets		**Total**	**Restricted debt service**	**Other**
Money market government funds	$	247	—	247
Commercial paper		575	—	575
Government securities		30,750	30,750	—
		31,572	30,750	822
Less funds required for current liabilities		(6,041)	(6,041)	—
	$	25,531	24,709	822

Foundation – Assets limited as to use of $20.9 million and $23.1 million at February 29, 2016 and February 28, 2015, respectively, are restricted subject to donor-imposed stipulations that will be met by actions of the Foundation or the passage of time.

(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 HMO, and the Foundation each have formal investment policies adopted by the Board of Managers, Board of Directors, and Board of Trustees, respectively, 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 HMO's investments 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 Managers 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 AA 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 50% 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 investments as of February 29, 2016 and February 28, 2015 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).

	2016				
Security	**Fair value**	**Percentage of portfolio**	**Maturity amount**	**Modified duration (years)**	**Credit Rating S&P/ Rating Moody's**
Commercial paper:					
TMCC	$ 126,373	17.35%	$ 127,000	0.061	A-1+
UBS Financial	139,157	19.10	139,575	0.417	A-1
GE Capital Corporation	49,985	6.86	50,000	0.085	A-1+
Other:					
Cleveland County OK ISD	3,630	0.50	3,630	0.003	AA2
King County Washington	10,961	1.50	10,000	12.764	AAA/Aa3
San Antonio Texas Electric and Gas	1,238	0.17	1,190	15.934	AA
Austin Texas Water & Wastewater System	1,051	0.14	1,055	1.712	AA, Aa2
San Diego Unified School District	1,238	0.17	1,240	1.337	AA, Aa2
U.S. agency notes:					
Freddie Mac Discount Note	29,882	4.10	30,000	0.080	AAA/Aaa
FNMA	48,120	6.61	48,162	0.649	AA+/Aaa
FHLMC	114,534	15.72	114,615	1.486	AA+/Aaa
U.S. Treasury Note	49,892	6.85	49,876	0.960	AAA/Aaa
Money market mutual funds	152,441	20.93	152,441	0.003	AAA/Aaa
Total cash and investments	$ 728,502	100.00%	$ 728,784	0.773	

	2015				
Security	**Fair value**	**Percentage of portfolio**	**Maturity amount**	**Modified duration (years)**	**Credit Rating S&P/ Rating Moody's**
Commercial paper:					
GE Credit Corp.	$ 49,904	8.56%	$ 50,000	0.592	A-1+
TMCC	111,403	19.10	111,500	0.352	A-1+
UBS Financial	204,632	35.09	205,075	0.569	A-1
Other:					
Cleveland City, OK ISD	3,673	0.63	3,630	1.005	AA2
King County Washington	11,253	1.93	10,000	13.767	AAA
San Antonio Texas Electric and Gas	1,275	0.22	1,190	16.937	AA
Marion & Polk Ctys Ore School	1,280	0.22	1,280	0.293	Aa1
U.S. agency notes:					
FHLB	41,298	7.08	41,300	1.118	Aaa/AA+
FNMA	10,736	1.84	10,777	3.455	AAA/AA+
FHLMC	5,005	0.86	5,000	2.123	Aaa/AA+
Money market mutual funds	142,756	24.47	142,756	0.003	AAA/Aaa
Total cash and investments	$ 583,215	100.00%	$ 582,508	0.758	

The System maintained no investments in derivatives at February 29, 2016 and February 28, 2015.

The table below indicates the fair value and maturity amount of the HMO's investments as of December 31, 2015 and 2014 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).

	2015				
Security	Fair value	Percentage of portfolio	Maturity amount	Modified duration (years)	Credit Rating S&P/ Rating Moody's
Commercial paper:					
TMCC	$ 24,864	11.40%	$ 25,000	0.616	A-1+
U.S. agency notes:					
FHLB	39,950	18.32	40,000	0.551	AA+/Aaa
FHLMC	49,901	22.88	50,000	1.785	AA+/Aaa
FNMA	29,857	13.69	30,000	2.085	AAA
Time deposit:					
Amegy Bank	3,325	1.53	3,325	0.432	AAA
Money market mutual funds	70,175	32.18	70,175	0.007	AAA
Total cash and investments	$ 218,072	100.00%	$ 218,500	0.873	

	2014				
Security	Fair value	Percentage of portfolio	Maturity amount	Modified duration (years)	Credit Rating S&P/ Rating Moody's
Commercial paper:					
UBS Financial	$ 79,914	44.93%	$ 80,000	0.094	A-1
GE Capital	14,956	8.41	15,000	0.192	A-1+
U.S. agency notes:					
FHLMC	17,529	9.86	17,751	2.901	Aaa/AA+
FNMA	29,936	16.83	30,000	3.085	AA+
Time deposit:					
Amegy Bank	3,323	1.87	3,323	0.429	AAA
JP Morgan Chase	3,323	1.87	3,323	0.391	AAA
Money market mutual funds	28,883	16.23	28,883	0.003	AAA
Total cash and investments	$ 177,864	100.00%	$ 178,280	0.926	

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 29, 2016 and February 28, 2015, the carrying amount of the HMO's demand and time deposits was $3.3 and $6.6 million, respectively, as was the balance per various financial institutions. 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 25% 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 24 months. Additionally, at least 15% 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 two years. As of February 29, 2016 and February 28, 2015, 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.

(7) Capital Assets

The System's investment in capital assets as of February 29, 2016 and February 28, 2015, consists of the following (in thousands):

	2016			
	Beginning balance	Additions/ transfers	Retirements	Ending balance
Land and improvements	$ 41,468	395	(71)	41,792
Buildings and fixed equipment	590,801	18,009	(2,143)	606,667
Major movable equipment	340,820	19,357	(21,691)	338,486
Total at historical cost	973,089	37,761	(23,905)	986,945
Less accumulated depreciation:				
Land and improvements	(9,274)	(1,079)	71	(10,282)
Buildings and fixed equipment	(286,782)	(24,425)	692	(310,515)
Major moveable equipment	(244,528)	(31,295)	21,137	(254,686)
Total accumulated depreciation	(540,584)	(56,799)	21,900	(575,483)
Construction in progress	21,599	(1,584)	—	20,015
Capital assets – net	$ 454,104	(20,622)	(2,005)	431,477

	2015			
	Beginning balance	Additions/ transfers	Retirements	Ending balance
Land and improvements	$ 41,059	535	(126)	41,468
Buildings and fixed equipment	566,189	26,724	(2,112)	590,801
Major movable equipment	334,804	27,053	(21,037)	340,820
Total at historical cost	942,052	54,312	(23,275)	973,089
Less accumulated depreciation:				
Land and improvements	(8,244)	(1,122)	92	(9,274)
Buildings and fixed equipment	(267,486)	(21,348)	2,052	(286,782)
Major moveable equipment	(231,270)	(34,114)	20,856	(244,528)
Total accumulated depreciation	(507,000)	(56,584)	23,000	(540,584)
Construction in progress	31,652	(10,053)	—	21,599
Capital assets – net	$ 466,704	(12,325)	(275)	454,104

(Continued)

Depreciation expense for the years ended February 29, 2016 and February 28, 2015 was $56,799,000 and $56,584,000, respectively.

(8) Long-Term Debt

(a) 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 cash 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 2007A Bonds bear interest at an effective rate of approximately 5.1% (stated rates ranging from 5% to 5.25%) and were issued as fixed rate bonds with a final maturity on February 15, 2042. 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. The Series 2007 Bonds are insured by municipal bond insurance policies and secured by a lien on the pledged revenues of the System and certain funds established pursuant to the bond order.

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 $21,531,000, which includes $16,230,000 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 $5,301,000 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 $11,786,000 at February 29, 2016 and $13,480,000 at February 28, 2015, respectively. Principal amounts of total defeased indebtedness outstanding at February 29, 2016 and February 28, 2015 are $93,800,000 and $105,900,000, respectively. The bonds are secured by an irrevocable letter of credit issued by JPMorgan Chase Bank.

(Continued)

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, 2014 has been amended and extended to August 12, 2016. Unreimbursed advances will accrue interest at the higher of (i) the Prime Rate, (ii) one-month LIBOR plus 2.5%, or (iii) 7.5% per annum. The System is also required to pay to the JPMorgan Chase Bank an annual facility fee for the letter of credit of 0.65% per annum of the outstanding principal amount of the bonds. No amounts were outstanding on the letter of credit as of February 29, 2016 and February 28, 2015. 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 29, 2016 and February 28, 2015.

(b) 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%.

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 ($19.0) and ($13.0) million at February 29, 2016 and February 28, 2015, respectively, and is reported as a derivative liability in the balance sheet. 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 29, 2016 and February 28, 2015.

Credit Risk – The risk of a change in the credit quality or credit rating of theSystem and/or its counterparty. As of February 29, 2016 and February 28, 2015, the swap counterparty was rated BBB+ and A respectively by Standard & Poor's and A3 and A2 respectively by Moody's Investors Services. At February 29, 2016 and February 28, 2015, the System was rated A2 by Moody's Investors Services and A by both Standard & Poor's and 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 29, 2016 and February 28, 2015, 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 29, 2016 and February 28, 2015, termination of the original swap agreement would create a liability of $34.2 and $28.5 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 29, 2016, 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.

	Debt principal	Debt interest	Swaps, net	Total
Year ending February:				
2017	$ 5,635	13,347	(2,816)	16,166
2018	5,870	13,082	(2,753)	16,199
2019	6,130	12,805	(2,689)	16,246
2020	6,400	12,517	(2,621)	16,296
2021	6,705	12,215	(2,551)	16,369
2022–2026	38,505	56,031	(11,589)	82,947
2027–2031	48,635	45,863	(9,334)	85,164
2032–2036	61,375	32,928	(6,575)	87,728
2037–2041	78,025	16,335	(3,208)	91,152
2042	17,965	892	(172)	18,685
Total	$ 275,245	216,015	(44,308)	446,952

(Continued)

Using interest rates as of February 28, 2015, 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.

		Debt principal	Debt interest	Swaps, net	Total
Year ending February:					
2016	$	5,415	13,602	(2,866)	16,151
2017		5,635	13,347	(2,806)	16,176
2018		5,870	13,082	(2,744)	16,208
2019		6,130	12,805	(2,680)	16,255
2020		6,400	12,516	(2,612)	16,304
2021–2025		36,780	57,766	(11,948)	82,598
2026–2030		46,405	48,107	(9,791)	84,721
2031–2035		58,530	35,777	(7,146)	87,161
2036–2040		74,400	19,986	(3,927)	90,459
2041–2042		35,095	2,629	(507)	37,217
Total	$	280,660	229,617	(47,027)	463,250

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 29, 2016 and February 28, 2015 was as follows (in thousands):

		2016	2015
Beginning balance	$	13,571	14,417
Additions		—	—
Reductions		(829)	(846)
Ending balance	$	12,742	13,571

The following table sets forth as of February 29, 2016 and February 28, 2015, the amortization of the hybrid instrument borrowings for the next five years and thereafter (in thousands).

		February 29, 2016			February 28, 2015
Years ending February:			Years ending February:		
2017	$	811	2016	$	828
2018		792	2017		811
2019		773	2018		792
2020		754	2019		773
2021		733	2020		754
2022–2026		3,333	2021–2025		3,447
2027–2031		2,684	2026–2030		2,825
2032–2036		1,891	2031–2035		2,062
2037–2041		922	2036–2040		1,133
2042		49	2041–2042		146
Total	$	12,742		$	13,571

(c) Other Obligations

Other long-term obligations at February 29, 2016 and February 28, 2015, are as follows (in thousands):

		2016		
		Principal	Interest	Total
Years ending February:				
2017	$	51	2	53
2018		51	2	53
2019		48	1	49
2020		40	—	40
2021		14	—	14
Total	$	204	5	209

		2015		
		Principal	Interest	Total
Years ending February:				
2016	$	184	6	190
2017		124	3	127
2018		109	1	110
2019		54	—	54
Total	$	471	10	481

(Continued)

(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 Managers 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% 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%. 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.

(a) 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 year 2015 and $17,500 during calendar year 2014 for all participants. Contributions to the plan cannot exceed the statutory maximum of $24,000 and $23,000 during calendar year 2015 and 2014, respectively, for participants age 50 and older. Effective July 2007, the System enhanced the (401(k) Plan) with an employer match up to 5% of the participant's compensation for eligible employees, which is 100% 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 $26,532,280 and $25,022,814 in fiscal years 2016 and 2015 respectively. Total System contributions recorded as pension expense were $9,002,377 and $8,239,823 in fiscal years 2016 and 2015, respectively.

(b) 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 Managers of the System, which is responsible for administering the Plan under the terms that are established. The Board of Managers 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.

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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% 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% 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 nonhighly 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.

At December 31, 2015, the following employees were covered by the benefit terms:

Inactive employees or beneficiaries currently receiving benefits	$	2,774
Inactive employees entitled to but not yet receiving benefits		1,702
Active employees		2,966
	$	7,442

The Harris Health System Board of Managers 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 29, 2016 the System's average contribution rate was 16.09% of the annual covered-employee payroll.

(c) Net Pension Liability

The System's net pension liability was measured as of December 31, 2015 and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date, 2015.

Actual assumptions used in the January 1, 2015 actuarial valuation are as follows:

Inflation	3.0 percent
Salary Increases	4.0 percent, ultimate rate
Investment rate of return	7.5 percent, net of pension plan investment expense, including inflation

Mortality rates for healthy annuitants were based on the RP-2014 bottom quartile mortality tables with generational mortality improvement projected after 2014 with 50% of Scale MP-2014. Rates for disabled annuitants were based on the RP-2014 disability mortality table. The actuarial assumptions used in the January 1, 2015 valuation were based on the results of an actuarial experience study for the period 2008-2011.

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 for each major asset class are summarized in the following table:

Asset class	**Target allocation**	**Long-term expected real rate of return**
Domestic equity-large cap	43%	9.25%
Domestic equity-small cap	7	11.00%
International equity	18	9.75%
Fixed income	32	4.25%
Cash	—	—%
	100%	

The discount rate used to measure the total pension liability was 7.5% net of expenses. 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, 2014	$	780,432	584,261	196,171
Changes for the year:				
Service cost		7,795	—	7,795
Interest		57,482	—	57,482
Differences between expected and actual experience		4,637	—	4,637
Contributions – employer		—	31,759	(31,759)
Net investment income		—	(4,891)	4,891
Benefit payments		(44,023)	(44,023)	—
Administrative expense		—	(2,389)	2,389
Net Changes	$	25,891	(19,544)	45,435
Balances at December 31, 2015	$	806,323	564,717	241,606

(Continued)

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 7.5%, 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 (6.5%) or 1 percentage point higher (8.5%) than the current rate (in thousands):

		1% Decrease 6.5%	**Current discount 7.5%**	**1% Increase 8.5%**
System's net pension liability	$	338,477	241,606	159,418

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

For the fiscal year ended February 29, 2016, the System recognized pension expense of $33,877,000. At February 29, 2016, the System reported deferred outflows and deferred inflows of resources related to pension from the following sources:

		Deferred outflows of resources	**Deferred inflows of resources**
Differences between expected and actual experience	$	3,101,671	—
Net difference between projected and actual earnings on pension plan investments		40,215,942	—
Total	$	43,317,613	—

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

Year ended the last day of February:		
2017	$	11,589,465
2018		11,589,465
2019		10,084,696
2020		10,053,987

The following disclosure is included in accordance with GASB Statement No. 27, *Accounting for Pensions of State and Local Government Employers*, for fiscal year 2015 only.

Annual Pension Cost and Net Pension Asset

The contribution requirements for the System's fiscal year are based on an actuarial valuation as of two months before the beginning of the fiscal period, as follows:

Fiscal year ended	Annual pension cost (APC)	Percentage of APC contributed	Net pension asset
February 28, 2015	$ 31,343,689	100%	$ 2,179,741

The Plan is on a calendar year-end, and for the plan year ended December 31, 2014, the actuarially determined contribution requirement was $31,292,164 and intended to cover normal cost of $14,695,864 and $14,413,126 for amortization of the unfunded actuarial accrued liability and represented 14.8% of January 1, 2014, covered payroll.

During the year ended February 28, 2015, the System made cash contributions of $31,292,164 to the pension trust. Pension expense recognized in the statements of revenues, expenses, and changes in net position was $31,343,689.

The annual pension cost equals the annual required contribution, minus one year's interest on the net pension asset, plus an adjustment for amortization of the net pension asset. The annual pension cost and net pension asset for the year ended December 31, 2015 was as follows:

Annual required contribution	$ 31,292,164
Interest discount on net pension asset	(167,345)
Adjustment to annual required contribution	218,870
Annual pension cost	31,343,689
Contributions made	31,292,164
Decrease in net pension asset	(51,525)
Net pension asset – beginning of year	2,231,266
Net pension asset – end of year	$ 2,179,741

As of January 1, 2014, the most recent actuarial valuation date, the Plan was 76.0% funded. The actuarial accrued liability for benefits was $657,817,000, and the actuarial value of assets was $499,862,000, resulting in an unfunded actuarial accrued liability (UAAL) of $157,955,000. The covered payroll (annual payroll of active employees covered by the Plan) was $210,728,000, and the ratio of the UAAL to the covered payroll was 75.0%.

The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

Actuarial methods and assumptions used in the January 1, 2014 actuarial valuation are as follows:

Actuarial cost method	Projected unit credit
Equivalent single amortization period	20 years
Asset valuation method	Five-year smoothed market
Actuarial assumptions:	
Inflation	3.0%
Investment rate of return (net of expenses)	7.5
Projected salary increases (ultimate rate)	4.0
Mortality rates:	
Health Pre-Commencement	RP-2000 Combined Mortality Table with Improvement to 2050 under Scale AA
Health Post-Commencement	RP-2000 Combined Mortality Table
Disabled	UP84, +4 Male and -1 Female rates, multiplied by 200%

(d) 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 balance sheet, are not subject to creditors. The Deferred Compensation Plan assets at February 29, 2016 and February 28, 2015 were approximately $81,574,279 and $87,863,329, respectively.

(e) 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, 2015 included 1,959 retirees and 7,443 active employees. As of March 1, 2014, covered employees included 1,913 retirees and 7,066 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 Managers. For fiscal years 2016 and 2015, the System contributed $18 million and $19 million, respectively, to the Plan for current premiums and administrative costs. Plan members receiving benefits during fiscal years 2016 and 2015 contributed $4 million and $3 million, respectively, or approximately 20% and 16%, respectively, of the total premiums, through their required contribution of $79.17 per month and $73.25 per month, respectively, for retiree-only coverage and $493.00 and $451.50, respectively, for retiree and spouse coverage.

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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 2016 and 2015, the amount actually contributed to the Plan, and changes in the System's net OPEB obligation to the Plan (in thousands):

		2016	2015
Annual required contribution	$	37,317	37,703
Interest on net OPEB obligation		8,536	7,673
Adjustment to annual required contribution		(8,885)	(7,987)
Annual OPEB cost/expense		36,968	37,389
Contributions		14,646	15,834
Increase in net OPEB obligation		22,322	21,555
Net OPEB obligation – beginning of year		213,397	191,842
Net OPEB obligation – end of year	$	235,719	213,397

The System's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for 2016 and 2015 were as follows (in thousands):

		2016			
Fiscal year		Annual OPEB cost	Percentage of OPEB contributed		Net OPEB obligation
2016	$	36,968	40%	$	235,719
2015		37,389	42		213,397

As of the March 1, 2015 and 2014 actuarial valuations, the Plan was not prefunded. Contributions made were for current-year costs incurred only. The actuarially accrued liability for benefits was $476.3 million and $495.8 million for March 1, 2015 and 2014, respectively, and the actuarial value of assets was $0 resulting in an unfunded actuarial accrued liability of $476.3 million and $495.8 million for March 1, 2015 and 2014, respectively. The covered payroll (annual payroll of active employees covered by the Plan) was $448.6 million and $430.0 million for March 1, 2015 and 2014, respectively. The ratio of the unfunded actuarial accrued liability to the covered payroll was 106.2% and 115.3% for March 1, 2015 and 2014, respectively.

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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, 2015 and 2014 actuarial valuations, the projected unit credit actuarial cost method was used and the actuarial assumptions included a 4% investment rate of return. The 2015 actuarial valuation assumptions included an annual healthcare cost trend rate of 6.5% reduced by decrements to an ultimate rate of 4.75% after 5 years. The 2014 actuarial valuation assumptions included an annual healthcare cost trend rate of 6.5% reduced by decrements to an ultimate rate of 4.75% 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 participants were based on the RP-2000 combined mortality table with improvement to 2050 under scale AA. Rates for healthy post-commencement participants were based on RP-2000 combined mortality table. Rates for disabled participants were based on UP84, +4 Male and -1 Female rate, multiplied by 200%.

(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 29, 2016 and February 28, 2015 is as follows:

	2016	2015
Medicaid	20%	21%
Medicare	22	28
Commercial	16	11
Self-pay patient	42	40
	100%	100%

(11) Commitments and Contingencies

At February 29, 2016 and February 28, 2015, 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 29, 2016, 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 29, 2016 and February 28, 2015 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:					
2016	$	1,788	1,415	1,928	1,275
2015		4,165	(2,243)	134	1,788
Workers' compensation liability:					
2016		2,293	1,567	1,495	2,365
2015		2,518	1,343	1,568	2,293
Employee healthcare benefits liability:					
2016		9,340	91,787	92,641	8,486
2015		9,382	85,813	85,855	9,340

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 balance sheet.

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 29, 2016, the System had commitments outstanding in the amount of approximately $16.4 million related to improvements at existing facilities and $4.8 million related to information technology projects.

At February 28, 2015, the System had commitments outstanding in the amount of approximately $0.1 million related to construction of new facilities, $11.5 million related to improvements at existing facilities, and $3.3 million related to information technology projects.

The System had rental expenses related to its operating leases of approximately $11,270,000 and $10,905,000 during the years ended February 29, 2016 and February 28, 2015, 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.

(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, 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.

(Continued)

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 $258 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 29, 2016 and February 28, 2015, the System utilized $243.8 million and $196.3 million of tax revenues, respectively, as the nonfederal share of the Harris Collaborative program. The System recorded expenses of $190.3 million and $188.0 million in 2016 and 2015, 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.

(13) Subsequent Events

The System evaluated subsequent events from February 29, 2016 through June 20, 2016, the date on which the financial statements were available to be issued. No events occurred that require consideration as adjustments to or disclosures in the financial statements.

REQUIRED SUPPLEMENTARY INFORMATION

HARRIS COUNTY HOSPITAL DISTRICT,
dba HARRIS HEALTH SYSTEM,
A COMPONENT UNIT OF HARRIS COUNTY, TEXAS

Schedule of Changes in the System's Net Pension Liability
and Related Ratios

Last 10 Fiscal Years

(Dollar amounts in thousands)

(Unaudited)

		2015	2014
Total pension liability			
Service cost	$	7,795	8,642
Interest		57,482	52,342
Changes of benefit terms		—	—
Difference between expected and actual experience		4,637	(1,909)
Changes of assumptions		—	40,689
Benefit payments		(44,023)	(34,444)
Net change in total pension liability		25,891	65,320
Total pension liability – beginning		780,432	715,112
Total pension liability – ending (a)		806,323	780,432
Plan fiduciary net position			
Contributions – employer		31,759	31,292
Net investment income		(4,891)	37,069
Benefit payments		(44,023)	(34,444)
Administrative expense		(2,389)	(2,302)
Net change in plan fiduciary net position		(19,544)	31,615
Plan fiduciary net position – beginning		584,261	552,646
Plan fiduciary net position – ending (b)		564,717	584,261
System's net pension liability – ending (a) – (b)	$	241,606	196,171
Plan fiduciary net position as a percentage of the total pension liability		70.04%	74.86%
Covered-employee payroll	$	197,360	210,728
System's net pension liability as a percentage of covered-employee payroll		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.

This schedule is presented to illustrate the requirement to show information for 10 fiscal years. However, until a full 10-year trend is compiled, the System will present information for those years for which information is available.

HARRIS COUNTY HOSPITAL DISTRICT,
dba HARRIS HEALTH SYSTEM,
A COMPONENT UNIT OF HARRIS COUNTY, TEXAS

Schedule of Employer Contributions

(Dollar amounts in thousands)

(Unaudited)

		2015	**2014**
Actuarially determined contribution	$	31,759	31,292
Contributions in relation to the actuarially determined contribution		31,759	31,292
Contribution deficiency (excess)	$	—	—
Covered employee payroll	$	197,360	210,728
Contributions as a percentage of covered employee payroll		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	Level dollar, closed
Remaining amortization period	19 years
Asset valuation method	Market value
Inflation	3.0%
Salary increases	4.0% ultimate rate
Investment rate of return	7.5%, 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 2014 with 50% of Scale MP-2014

This schedule is presented to illustrate the requirement to show information for 10 fiscal years. However, until a full 10-year trend is compiled, the System will present information for those years for which information is available.

HARRIS COUNTY HOSPITAL DISTRICT,
dba HARRIS HEALTH SYSTEM,
A COMPONENT UNIT OF HARRIS COUNTY, TEXAS

Schedule of Funding Progress of Defined Benefit Pension Plan

Three-Year Historical Trend Beginning January 1, 2012

(Unaudited)

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)
January 1, 2012	$	450,121	576,557	126,436	78.1	229,056	55.2
January 1, 2013		456,765	639,144	182,379	71.5	220,398	82.7
January 1, 2014		499,862	657,817	157,955	76.0	210,728	75.0

Dollar amounts in thousands.

See accompanying independent auditors’ report.

HARRIS COUNTY HOSPITAL DISTRICT,
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A COMPONENT UNIT OF HARRIS COUNTY, TEXAS

Schedule of Actuarial Data for Defined Benefit Pension Plan

January 1, 2014

(Unaudited)

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

Valuation date	January 1, 2014
Actuarial cost method	Projected unit credit
Amortization method	Level dollar, open
Amortization period	20 years
Asset valuation method	Five-year smoothed market
Actuarial assumptions:	
Inflation	3.0%
Investment rate of return	7.5%
Projected salary increases (ultimate rate)	4.0%
Cost-of-living adjustments	Not applicable
Mortality rates:	
Healthy Pre-Commencement	RP-2000 Combined Mortality Table with Improvement to 2050 under Scale AA
Healthy Post-Commencement	RP-2000 Combined Mortality Table
Disabled	UP84, +4 Male and -1 Female rates, multiplied by 200%

See accompanying independent auditors’ report.

HARRIS COUNTY HOSPITAL DISTRICT,
dba 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, 2013

(Dollar amounts in thousands.)

(Unaudited)

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, 2013	—	504,029	504,029	—	381,441	132.1
March 1, 2014	—	495,780	495,780	—	429,915	115.3
March 1, 2015	—	476,333	476,333	—	448,575	106.2

See accompanying independent auditors’ report.