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

Financial Statements

February 28, 2013 and February 29, 2012

(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:

Report on the Financial Statements

We have audited the accompanying financial statements of the business-type activities and the aggregate discretely presented component units of Harris County Hospital District, dba Harris Health System (the System), a component unit of Harris County, Texas, as of and for the years ended February 28, 2013 and February 29, 2012, 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 14.7%, 24.3%, and 0.8% of the 2013 and 17.7%, 25.7% and 3.6% of the 2012 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 report 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 audit. 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 opinions.

Opinions

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 28, 2013 and February 29, 2012, 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.

Other Matters

Required Supplementary Information

U.S. generally accepted accounting principles require that the management's discussion and analysis and supplementary schedules on pages 3-11 and 49-51, 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, 2013 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, 2013

This section of the Harris Health System's (the System) financial report presents background information and management's analysis of the System's financial results for the fiscal years ended February 28, 2013 and February 29, 2012. This section should be read in conjunction with the System's financial statements, which begin on page 12.

Financial Highlights

- The System's net position decreased $31 million (4.0%) in fiscal 2013 and increased $7 million (0.9%) between fiscal 2011 and 2012.
- Total assets increased $56 million (4.1%) between fiscal 2012 and fiscal 2013. Total assets increased $40 million (3.0%) between fiscal 2011 and fiscal 2012.
- Long-term debt, including current portion, decreased $5 million (1.8%) between fiscal 2012 and fiscal 2013 and decreased $3 million (1.1%) between fiscal 2011 and fiscal 2012. Other liabilities increased $92 million (30.3%) between fiscal 2012 and 2013 as a result of outstanding commitments under the Harris Collaborative Program and the System's post employment health benefits plan. Other liabilities increased $36 million (13.4%) in fiscal 2012.
- Community Health Choice, Inc. experienced a 4.8% growth in membership during fiscal 2013 and 14.6% growth in fiscal 2012.
- The number of unduplicated patients served by the System remained relatively flat between fiscal 2012 and fiscal 2013. Services provided on an inpatient basis decreased 1.8%, while emergency care/urgent visits remained flat. Community health center and specialty clinic visits, and other outpatient diagnostic visits increased 3.5% and 1.4%, respectively. In fiscal 2012, the System experienced a 2.9% decline in the number of unduplicated patients served. Services provided on an inpatient basis decreased 4.9%, while emergency care/urgent care visits decreased 2.9%. Community health center and specialty clinic visits, and other outpatient diagnostic visits increased 4.1%, and 9.5%, respectively.
- Access to surgical services continues as a challenge. In fiscal 2013, total surgeries decreased 1.3%. Outpatient cases increased 0.9% and at the same time, inpatient surgeries declined 3.2%. In fiscal 2012, total surgeries increased 0.6%. Outpatient cases increased 8.9% and at the same time, inpatient surgeries declined 5.5%, reflecting a shift from inpatient to outpatient care and delivery of care in a more cost effective manner.
- During fiscal 2013 and 2012, the System invested $119 million and $89 million, respectively, in space/facility expansion projects, critical information technology, and medical equipment. Significant capital acquisitions and resource investments included the following:

  Information Technology including a managed care claims system and remote portal and Web redesigns

(Continued)

In fiscal 2008 the System embarked on a multi-year plan of space and facility expansion projects. Expansion of outpatient ancillary services during fiscal 2013 and 2012 included:

- Five outlying clinic campuses
- Completion of the radiation and diagnostic clinic tower that opened early fall of 2012 at the administrative campus
- Renovations at the Ben Taub campus
- LBJ emergency center expansion completion
- LBJ specialty clinic construction

- The Harris County Hospital District Foundation's multiyear Capital Campaign has raised more than $23 million in gifts and commitments. A capital contribution of $10.1 million was made to the System in fiscal 2013.

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 term "net position" represents the difference between assets, or the System's investment in resources, and liabilities, or the System's obligation to its creditors. 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 statements 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 Statement of Net Position

(In millions)

		2013	2012	Dollar change	Total percentage change		2011	Dollar change	Total percentage change
Current and other assets	$	991	1,000	(9)	(0.9)%	$	1,002	(2)	(0.2)%
Capital assets		425	360	65	18.1		318	42	13.2
Total assets	$	1,416	1,360	56	4.1%	$	1,320	40	3.0%
Long-term debt outstanding	$	275	280	(5)	(1.8)%	$	283	(3)	(1.1)%
Other liabilities		396	304	92	30.3		268	36	13.4
Total liabilities	$	671	584	87	14.9%	$	551	33	6.0%
Invested in capital assets, net of related debt	$	135	99	36	36.4%	$	103	(4)	(3.9)%
Restricted		32	27	5	18.5		31	(4)	(12.9)
Unrestricted		578	650	(72)	(11.1)		635	15	2.4
Total net position	$	745	776	(31)	(4.0)%	$	769	7	0.9%

Total net position, the difference between the assets and liabilities reported, decreased $31 million in fiscal 2013. The overall decrease is the result of the loss reported for fiscal 2013. In fiscal 2012, net position increased $7 million as a result of the income reported for the year. The net loss/gain reported for fiscal 2013 and 2012 is discussed in detail following Table 2. Current and other assets decreased $9 million or 0.9% from fiscal 2012 to fiscal 2013, and decreased $2 million or 0.2% in fiscal 2012. The decrease in fiscal 2013 is primarily due to the expenditure of funds for the space and expansion projects. The fiscal 2012 decrease is primarily related to funding estimates as of February 29, 2012 and February 28, 2011 due to the System under the DSH/UPL/1115 Waiver programs (Medicaid supplemental programs). The growth in capital assets is discussed in detail following Table 3.

In fiscal 2013 and 2012, reductions in bond-related debt reflect scheduled debt service payments. The System's net obligation for the provision of certain post-employment healthcare benefits increased approximately $23 million during fiscal 2013 and $36 million during fiscal 2012. Obligations under the Harris Collaborative Program were $65 million greater at February 28, 2013 than February 29, 2012.

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 $193.0 million and $96.4 million at February 28, 2013 and February 29, 2012, respectively, related to these Medicaid supplemental programs. Medicaid supplemental programs revenue recorded in fiscal 2012 included $2.5 million in funding that exceeded program estimates for the 2011 program year. The February 2013 receivable includes $67.4 million and $125.6 million related to the 2012 and 2013 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 28, 2013 and February 29, 2012 and February 28, 2011, 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)

	2013	2012	2011
Operating revenues:			
Net patient service revenue	$ 294,778	308,624	290,309
Medicaid supplemental programs revenues	272,445	224,322	184,849
Other operating revenues	25,360	26,004	28,920
Total operating revenues	592,583	558,950	504,078
Operating expenses:			
Salaries, wages, and benefits	662,389	629,836	616,324
Purchased services, supplies, and other	439,008	401,632	368,287
Depreciation and amortization	51,588	47,064	42,624
Total operating expenses	1,152,985	1,078,532	1,027,235
Operating loss	(560,402)	(519,582)	(523,157)
Nonoperating revenues:			
Ad valorem tax revenues – net	508,424	511,593	504,496
Tobacco settlement revenues	9,719	10,753	11,153
Investment income	4,730	10,653	4,315
Other	3,167	1,435	(38)
Total nonoperating revenues	526,040	534,434	519,926
Nonoperating expenses:			
Deferred outflows – derivative financial instrument	—	—	(1,316)
Interest expense	(7,055)	(7,817)	(7,249)
Other	(19)	(95)	(606)
Total nonoperating expenses	(7,074)	(7,912)	(9,171)

Table 2

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

(In thousands)

		2013	2012	2011
(Loss) income before other revenues, expenses, gains, losses, and transfers	$	(41,436)	6,940	(12,402)
Capital contributions		10,272	—	—
Change in net position		(31,164)	6,940	(12,402)
Total net position – beginning of year, as restated		775,701	768,761	781,163
Total net position – end of year	$	744,537	775,701	768,761

Revenues

During the year ended February 28, 2013, the System's total operating revenue increased by $34 million (6.0%). Operating revenues increased $55 million (10.9%) during the year ended February 29, 2012.

- Net patient service revenue decreased $13.8 million from fiscal 2012 to fiscal 2013 due to increased services in an ambulatory setting with lower reimbursement rates and an increase in the number of patients served with no funding source. Net patient service revenue increased $18.3 million from fiscal 2011 to fiscal 2012 due to increased service volumes and reimbursement from third-party payors and patients.
- Estimated revenues from the Medicaid supplemental programs increased $48.1 million in fiscal 2013 and $39.5 million in fiscal 2012 with the inclusion of additional uncompensated care costs that were not previously recoverable.
- Other operating revenues decreased $.6 million for fiscal 2013. A decrease of $2.9 million for fiscal 2012 was primarily due to reductions in trauma care funding.

Operating Expenses

During the year ended February 28, 2013, total operating expenses increased $74.5 million (6.9%).

- System salaries and wages increased $24.8 million (5.3%). The compensation plan remained competitive with merit increases and an average salary increase of 1.5%. Total staffing increased 3.4% with a productivity improvement of 2.0%.
- Related benefits increased 4.7% due to employee health plan expense increases.
- Purchased medical services, supplies, and other operating expenses increased 9.3%, primarily as a result of increased service volumes and costs incurred under the Harris Collaborative Program.

(Continued)

During the year ended February 29, 2012, total operating expenses increased $51.3 million (5.0%).

- System salaries and wages increased $7.1 million (1.6%). The compensation plan remained competitive with merit increases and an average salary increase of 0.7%. Total staffing increased 0.6% with a productivity improvement of 3.8%.
- Related benefits increased 4.0% due to employee health plan expense increases.
- Purchased medical services, supplies, and other operating expenses increased 9.1%, primarily as a result of increased service volumes.

Overall, the System's operating loss increased 7.9% from 2012 to 2013 and improved 0.7% in fiscal 2012 as a result of the items discussed above. The System receives property tax revenues to subsidize the cost of services provided to qualified uninsured patients. Although the costs incurred to provide these services are reflected above as operating expenses, the property tax revenues are required to be reported as nonoperating revenues.

Nonoperating revenues and expenses consist of revenues and expenses related to financing and investing types of activities, including grants and donations for activities not considered as operating activities, and include property tax revenue, investment income, tobacco settlement funds, interest expense, gains or losses on disposal of assets, and certain grants and donations. Tax revenues, net of related expenses, decreased $3.2 million, or 0.6%, in 2013 compared to an increase in fiscal 2012 of $7.1 million or 1.4%. Investment income decreased $5.9 million in fiscal 2013 compared to an increase of $6.3 million reported for fiscal 2012. In fiscal 2013 the System received approximately $9.8 million in tobacco settlement revenue compared to $10.8 million in 2012. Nonoperating grants and donations and gains/losses on disposal of assets totaled $3.2 million in fiscal 2013 compared to $1.4 million in fiscal 2012.

Capital Assets and Debt Financing

During fiscal 2013 and 2012, the System invested $119 million and $89 million, respectively, in information technology, equipment, and facility expansion and renovation. Table 3 summarizes the changes in the System's capital assets between February 28, 2013 and February 29, 2012 and February 28, 2011:

Table 3

Capital Assets

(In thousands)

	2013	2012	Dollar change	Total percentage change	2011	Dollar change	Total percentage change
Land and improvements	$ 39,100	37,280	1,820	5.0%	$ 36,631	649	2.0%
Buildings and fixed equipment	477,767	406,023	71,744	18.0	391,667	14,356	4.0
Major movable equipment	311,390	273,285	38,105	14.0	260,462	12,823	5.0
Subtotal	828,257	716,588	111,669	16.0	688,760	27,828	4.0
Less accumulated depreciation	(467,803)	(430,578)	(37,225)	(9.0)	(398,046)	(32,532)	(8.0)
Construction in progress	64,930	74,366	(9,436)	(13.0)	27,522	46,844	170.0
Capital assets – net	$ 425,384	360,376	65,008	18.0%	$ 318,236	42,140	13.0%

In 2008, the System embarked on a multiyear plan with an estimated cost of $364 million in capital projects for the expansion of existing diagnostic and treatment facilities to improve access to healthcare services. As of February 28, 2013 the estimated cost of identified projects was $367 million and approximately $225 million has been expended for these projects. It is anticipated that additional funds of $40 million will be expended in the upcoming year.

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 2014 includes an investment of $51 million in routine capital expenditures. The capital projects include $12 million in information technology primarily dedicated to current system upgrades and technology refresh, $17 million specific to medical capital, and $22 million in renovations of current facilities.

At February 28, 2013 and February 29, 2012, the System had $273.9 million and $276.4 million, respectively, in outstanding revenue bonds, net of any discounts, premiums, and deferred refunding losses. 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. 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 28, 2013, February 29, 2012, and February 28, 2011:

Table 4

Long-Term Debt and Other Long-Term Obligations

(In thousands)

		2013	2012	2011
Series 2007 tax-exempt revenue bonds, including premium and deferred loss on refunding	$	190,855	193,735	196,475
Series 2010 revenue bonds, including deferred loss on refunding		83,002	82,659	88,294
Borrowing payable – interest rate swap		15,280	16,159	17,546
Derivative liability		10,057	10,904	—
Other long – term obligations		1,182	3,928	4,185
Total long-term debt and other long-term obligations		300,376	307,385	306,500
Less current portion		(5,877)	(6,553)	(5,825)
Noncurrent portion	$	294,499	300,832	300,675

The System's long-term debt and short term debt ratings at February 28, 2013 are "AA" and "FI". At February 29, 2012, these ratings were "AA+" and "FI+", respectively.

Economic Conditions and Plan for Fiscal 2014

In planning for fiscal 2014, 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:

- Population growth in Harris County, including growth in the number of uninsured and working poor, 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
- Current and future funding available under the DSH and 1115 Waiver programs
- Property tax funding and the valuation of properties within Harris County
- Monitoring of the expansion and renovations projects under the Strategic Capital Initiatives Plan and continued development of the long-range operating, facilities, and financial plan related to these capital initiatives
- 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 implementation of a regional healthcare plan under the new Texas 1115 Waiver Program
- 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
  - Maintaining financial strength and stability and positioning the System to succeed in an evolving healthcare reform environment.

Contacting the System's Financial Management

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

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

Statements of Net Position

February 28, 2013 and February 29, 2012

(In thousands)

	2013			2012		
		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	$ 74,490	2,126	17,025	237,266	2,326	13,009
Short-term investments (notes 5 and 6)	231,132	—	108,094	105,368	—	38,093
Accounts receivable – net of allowance for uncollectible accounts of $81,608 and $170,840 (note 10)	59,167	—	—	82,209	—	—
Current portion of ad valorem taxes receivable – net of allowance for uncollectible taxes of $5,098 and $5,158	22,511	—	—	28,216	—	—
Inventories	8,584	—	—	8,355	—	—
Medicaid supplemental programs receivable	193,008	—	—	96,400	—	—
Prepaid expenses and other current assets	12,780	671	20,984	9,431	1,199	14,591
Estimated third-party payor settlements	6,813	—	—	5,809	—	—
Due from Community Health Choice, Inc.	3,620	—	—	4,063	—	—
Current portion of assets limited as to use or restricted (notes 5 and 6)	39,611	—	—	37,847	—	—
Total current assets	651,716	2,797	146,103	614,964	3,525	65,693
Assets limited as to use or restricted – net of current portion (notes 5 and 6):						
Debt service	25,159	—	—	19,743	—	—
Capital expansion	139,556	—	—	209,157	—	—
Self-insured programs and other	157,458	14,658	—	136,519	22,241	—
Total assets limited as to use or restricted – net	322,173	14,658	—	365,419	22,241	—
Capital assets (notes 7 and 11):						
Land and improvements	39,100	—	—	37,280	—	—
Buildings and fixed equipment	477,767	—	—	406,023	—	—
Major movable equipment	311,390	—	—	273,285	—	—
Less accumulated depreciation	(467,803)	—	—	(430,578)	—	—
Total depreciable capital assets – net	360,454	—	—	286,010	—	—
Construction in progress	64,930	—	—	74,366	—	—
Capital assets – net	425,384	—	—	360,376	—	—
Other assets:						
Ad valorem taxes receivable – net of current portion and allowance for uncollectible taxes of $48,761 and $51,480	623	—	—	1,690	—	—
Net pension asset (note 9)	2,284	—	—	2,335	—	—
Long-term investments (note 6)	—	—	29,703	—	—	115,119
Deferred bond issue costs – net of accumulated amortization of $1,037 and $824	3,812	—	—	4,025	—	—
Other assets	24	12,786	—	24	13,200	—
Total other assets	6,743	12,786	29,703	8,074	13,200	115,119
Deferred outflow of resources – derivative financial instrument	10,057	—	—	10,904	—	—
Total assets and deferred outflows of resources	$ 1,416,073	30,241	175,806	1,359,737	38,966	180,812

(Continued)

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

Statements of Net Position

February 28, 2013 and February 29, 2012

(In thousands)

	2013			2012		
		Component units			Component units	
Liabilities and Net Position	**Harris Health System**	**Foundation**	**Community Health Choice, Inc.**	**Harris Health System**	**Foundation**	**Community Health Choice, Inc.**
Current liabilities:						
Accounts payable and accrued liabilities	$ 116,741	3	5,085	52,617	39	6,826
Interest payable	629	—	—	605	—	—
Employee compensation and related benefit liabilities (note 11)	41,081	—	—	33,524	—	—
Post employment health benefit liability (note 9)	13,300	—	—	11,600	—	—
Compensated absences	40,738	—	—	39,480	—	—
Medical claims liability (note 2)	—	—	72,203	—	—	57,414
Due to Harris Health System	—	—	4,307	—	—	3,816
Estimated third-party payor settlements	2,082	—	—	3,194	—	—
Current portion of long-term debt and capital leases (note 8)	5,877	—	—	6,553	—	—
Total current liabilities	220,448	3	81,595	147,573	39	68,056
Other long-term liabilities:						
Postemployment health benefit liability (note 9)	156,589	—	—	135,631	—	—
Borrowing payable (note 8)	15,280	—	—	16,159	—	—
Derivative liability	10,057	—	—	10,904	—	—
Other	141	—	—	—	—	—
Long-term debt (note 8):						
Series 2007 revenue bonds	187,830	—	—	190,855	—	—
Series 2010 revenue bonds – net of deferred loss on refunding of $16,983 and $19,221	81,042	—	—	80,764	—	—
Other long-term obligations – capital leases	149	—	—	2,150	—	—
Total liabilities	671,536	3	81,595	584,036	39	68,056
Commitments and contingencies (note 11)						
Net position:						
Invested in capital assets – net of related debt	135,206	—	—	99,027	—	—
Restricted for debt service	31,638	26,003	—	27,407	34,956	—
Unrestricted	577,693	4,235	94,211	649,267	3,971	112,756
Total net position	744,537	30,238	94,211	775,701	38,927	112,756
Total liabilities and net position	$ 1,416,073	30,241	175,806	1,359,737	38,966	180,812

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 28, 2013 and February 29, 2012

(In thousands)

	2013			**2012**		
		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)	$ 294,778	—	—	308,624	—	—
Medicaid supplemental programs revenue (note 4)	272,445	—	—	224,322	—	—
Premium revenue	—	—	637,929	—	—	512,562
Other operating revenues	25,360	2,283	674	26,004	16,698	2,507
Total operating revenues	592,583	2,283	638,603	558,950	16,698	515,069
Operating expenses:						
Salaries, wages, and benefits	662,389	535	24,934	629,836	581	23,247
Pharmaceuticals and supplies	179,690	6	1,402	166,626	21	1,323
Physician services (note 12)	154,136	—	—	136,367	—	—
Medical claims expense	—	—	600,824	—	—	428,412
Other purchased services	105,182	13,052	25,261	98,639	3,042	23,535
Depreciation and amortization	51,588	—	—	47,064	—	—
Total operating expenses	1,152,985	13,593	652,421	1,078,532	3,644	476,517
Operating (loss) income	(560,402)	(11,310)	(13,818)	(519,582)	13,054	38,552
Nonoperating revenues (expenses):						
Ad valorem tax revenues – net	508,424	—	—	511,593	—	—
Tobacco settlement revenues	9,719	—	—	10,753	—	—
Investment income	4,730	2,737	1,263	10,653	2,598	2,372
Interest expense (note 8)	(7,055)	—	—	(7,817)	—	—
Other	3,148	(116)	(5,990)	1,340	(115)	(1,498)
Total nonoperating revenues – net	518,966	2,621	(4,727)	526,522	2,483	874
Capital contributions	10,272	—	—	—	—	—
Changes in net position	(31,164)	(8,689)	(18,545)	6,940	15,537	39,426
Net position – beginning of year, as restated (note 2(s))	775,701	38,927	112,756	768,761	23,390	73,330
Net position – end of year	$ 744,537	30,238	94,211	775,701	38,927	112,756

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 28, 2013 and February 29, 2012

(In thousands)

		2013 Harris Health System	2012 Harris Health System
Operating activities:			
Receipts from and on behalf of patients	$	332,043	331,373
Receipts from Medicaid supplemental programs		175,837	144,364
Cash received from electronic health record incentive program		6,787	—
Payments to suppliers		(378,598)	(422,553)
Payments to employees and for employee benefits		(630,865)	(587,954)
Net cash used in operating activities		(494,796)	(534,770)
Noncapital financing activities:			
Contributions – net		2,587	1,435
Ad valorem taxes – net		515,196	516,181
Tobacco settlement revenues		9,719	10,753
Net cash provided by noncapital financing activities		527,502	528,369
Capital and related financing activities:			
Capital contributions		10,272	—
Acquisitions and construction of capital assets		(105,705)	(75,059)
Interest paid		(14,397)	(14,693)
Repayment of long-term debt		(6,100)	(5,867)
Net cash used in capital and related financing activities		(115,930)	(95,619)
Investing activities:			
Receipts of investment income – including realized gains and losses		4,633	8,860
Decrease (increase) in cash equivalents included in assets limited as to use or restricted		34,983	(15,777)
Purchases of investment securities		(776,338)	(943,379)
Proceeds from sale and maturities of investment securities		657,170	1,225,639
Net cash (used in) provided by investing activities		(79,552)	275,343
Net (decrease) increase in cash and cash equivalents		(162,776)	173,323
Cash and cash equivalents – beginning of year, as restated		237,266	63,943
Cash and cash equivalents – end of year	$	74,490	237,266

(Continued)

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

Statements of Cash Flows

Years ended February 28, 2013 and February 29, 2012

(In thousands)

		2013 Harris Health System	2012 Harris Health System
Reconciliation of operating loss to net cash used in operating activities:			
Operating loss	$	(560,402)	(519,582)
Adjustments to reconcile operating loss to net cash used in operating activities:			
Depreciation and amortization		51,588	47,064
Changes in operating assets and liabilities:			
Decrease (increase) in accounts receivable		23,042	(7,303)
Increase in inventories		(229)	(1,025)
Increase in Medicaid supplemental programs receivable		(96,608)	(79,957)
Increase in prepaid expenses and other assets		(2,906)	(1,623)
(Increase) decrease in estimated third-party payor settlements		(1,004)	1,156
Decrease in net pension asset		51	52
Increase (decrease) in accounts payable and accrued liabilities		61,311	(18,274)
Increase in employee compensation and related benefit liabilities		7,557	4,029
Increase in compensated absences		1,258	1,549
(Decrease) increase in estimated third-party payor settlements		(1,112)	2,892
Increase in postemployment health benefit liability		22,658	36,252
Total adjustments		65,606	(15,188)
Net cash used in operating activities	$	(494,796)	(534,770)
Supplemental disclosures of noncash operating, financing, and investing activities:			
Unrealized gain on investments	$	1,654	1,558
Amounts related to acquisition of capital assets in accounts payable and accrued liabilities		19,295	16,482
Amount of interest expense capitalized		8,866	7,241

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 15 health clinics; 4 specialty clinics providing dental, dialysis, HIV/AIDS treatment and outpatient specialty services; 7 school-based 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 District'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 are 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 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 had approximately 230,940 and 219,200 enrollees as of December 31, 2012 and 2011, respectively. The HMO offers 3 Medicaid insurance products. 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 balance sheets are primarily due to the presentation of the HMO's financials based on its fiscal 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@chchealth.org).

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 balance sheet; statements of revenues, expenses, and changes in net assets; and statements of cash flow.

The balance sheet requires that total net assets be reported in three components (a) invested in capital assets, net of related debt; (b) restricted; and (c) unrestricted.

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

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

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 District'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 2012, the System implemented GASB Statement No. 61, *The Financial Reporting Entity: Omnibus – An Amendment of GASB Statements Nos. 14 and 34*. As a result, the System reported the HMO and the Foundation as discretely presented component units in its financial statements for the years ended February 28, 2013 and February 29, 2012. 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. Previously the Foundation and the HMO were presented in the System's financial statements as blended component units. See further discussion in note 1(s).

Transactions between the System and its component units:

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 $1,019,000 annually 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. Financial commitments to the System for these projects include initiation of a Medical Home project based in outpatient clinics and the establishment and operation of additional pediatric clinics. Funds transferred to the System under these agreements are reflected as restricted contributions (distributions) in the statements of revenues, expenses, and changes in net assets.

The System supports the Foundation with payments for goods and services, approximately $702,000 and $763,000 in fiscal 2013 and 2012, 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 $1,888,000 and $1,996,000 in 2013 and 2012, respectively. In addition, in fiscal 2013 the Foundation made a contribution of $10,089,000 to the System from its multiyear 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 3 months maturities 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 Assets

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 System's expansion projects. Pledges are included in other assets in the balance sheet.

(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 greater 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 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 costs associated with the issuance of bonds are deferred 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 2013 and 2012 are as follows (in thousands):

Fiscal Year		Beginning-of-year liability	Current-year claims and changes in estimates	Claim payments	End-of-year liability
2013	$	39,480	53,301	52,043	40,738
2012		37,930	50,550	49,000	39,480

(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. In the last quarter of fiscal 2012 the System's financial assistance program for uninsured patients classified as self-pay was modified such that expected payments are based on the Medicare allowable reimbursement. Charges in excess of the expected payment are reflected as an administrative uninsured discount versus an uncollectible account or bad debt expense. The allowance for uncollectible accounts was estimated at $81,608,000 and $170,840,000 as of February 28, 2013 and February 29, 2012, 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

(Continued)

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. During 2013, the System recognized an increase in net patient service revenue of $3.8 million and during 2012, the System recognized a decrease in net patient service revenue of $1.1 million 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 28, 2013 and February 29, 2012.

	2013	2012
Charges foregone, based on established rates	$ 1,346,091,000	1,254,491,000
Cost of foregone charges, estimated	537,090,000	495,915,000

(m) Premium Revenue

Premium revenue is recognized as revenue during the coverage period of the subscriber agreement. Throughout the year, the HMO is notified 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 adequately recognized premium revenue for the years ended December 31, 2012 and 2011.

(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.

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, 2012, the HMO recognized a premium deficiency reserve in the amount of $6,837,593.

Changes in the HMO's aggregate liability for medical claims and premium deficiency reserve in fiscal years 2013 and 2012 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 and changes in estimates	End of fiscal year liability
2013	$	57,414	593,987	586,036	6,838	72,203
2012		43,530	428,412	414,528	—	57,414

In fiscal year 2013, the HMO paid $529.8 million in claims related to the current fiscal year and $56.2 million in claims related to the prior fiscal year. In fiscal year 2012, the HMO paid $375.3 million in claims related to the current fiscal year and $39.2 million in claims related to the prior fiscal year.

(o) 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.

(p) Tobacco Settlement Revenues

In the fiscal years ended February 28, 2013 and February 29, 2012, 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.

(q) 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.

(r) Newly Adopted Accounting Pronouncements

GASB Statement No. 57 – GASB Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*. This Statement amends Statement No. 45, *Accounting and Financial Reporting by Employers/or Postemployment Benefits other Than Pensions*, and Statement No. 43, *Financial Reporting/or Postemployment Benefit Plans Other Than Pension Plans*. This Statement clarifies actuarially determined Other Post Employment Benefits (OPEB) measures reported by an agent multiple-employer OPEB plan and its participating employers. Those measures should be determined by a common date and at a minimum frequency to satisfy the agent multiple-employer OPEB plan's financial reporting requirement. The System evaluated GASB Statement 57 and determined that the Statement had no impact on its financial position, results of operations, and cash flows.

GASB Statement No. 60 – GASB Statement No. 60, *Accounting and Financial Reporting/or Service Concession Arrangements (SCA)*. The Statement objective is to improve financial reporting by establishing recognition, measurement, and disclosure requirements for SCAs for both transferors and governmental operators, requiring governments to account for and report SCAs in the same manner, which improves the comparability of financial statements. The System has determined the Statement had no impact on the financial position, results of operations, and cash flows.

GASB Statement No. 63 – GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. This Statement standardizes the presentation of deferred outflows of resources and deferred inflows of resources and their effects on a government's net position. All applicable provisions have been applied to the System's financial statements.

GASB Statement No. 64 – GASB Statement No. 64 *Derivative Instruments: Application of Hedge Accounting Termination Provisions*. The Statement objective is to clarify whether an effective hedging relationship continues after the replacement of a swap counterparty or a swap counterparty's credit support provider. At this time, the System has determined that the Statement is not applicable.

Pending Adoption of Recent Account Pronouncements

GASB Statement No. 65 – The District has not completed the process of evaluating the impact that will result from implementing GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*. The Statement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. The Statement provisions are effective for financial statements for periods beginning after December 15, 2012.

GASB Statement No. 66 – The District has not completed the process of evaluating the impact that will result from implementing GASB Statement No. 66, *Technical Corrections – 2012, an amendment of GASB Statements No. 10 and No. 62*. The Statement amends Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues* and Statement No. 62, *Codification of Accounting and Financial reporting Guidance Contained in Pre-November 1989 FASB and AICPA Pronouncements*. The provisions of the Statement are effective for financial statements for periods beginning after December 15, 2012.

GASB Statement No. 68 – The System has not completed the process of evaluating the impact that will result from implementing GASB Statement No. 68, *Accounting and Financial Reporting for Pensions, an amendment of GASB Statement No. 27*. The Statement 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.

GASB Statement No. 69 – GASB Statement No. 69, *Government Combinations and Disposals of Government Operations*. The Statement establishes accounting and financial reporting standards related to government combinations and disposals of government operations to include transactions referred to as mergers, acquisitions, and transfers of operations. The Statement is effective for periods beginning after December 15, 2013. Earlier application is encouraged. At this time, the System has determined that the Statement is not applicable.

GASB Statement No. 70 – GASB Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*. The objective of the Statement is to improve accounting and financial reporting by state and local governments that extend and receive nonexchange financial guarantees. As a part of a nonexchange financial guarantee, a government commits to indemnify the holder of the obligation if the entity that issued the obligation does not fulfill its payment requirements. The Statement is effective for reporting periods beginning after June 15, 2013. Earlier application is encouraged. At this time the System has not completed the process of evaluating the impact that will result from implementing GASB Statement No. 70.

(s) Adoption of GASB Statement No. 61

As discussed in note 2(c), the System adopted GASB Statement No. 61 effective fiscal 2012. Application of this standard changed the presentation of the Foundation and HMO to discretely presented component units. Previously, the Foundation and HMO were presented as blended component units. As a result, the cumulative effect of applying this Statement has been reported as a restatement of beginning net assets of the System in the accompanying financial statements as follows (in thousands):

Net position, as of February 28, 2011 as previously reported	$	867,968
Reduction in net position for discrete presentation of HMO		(75,817)
Reduction in net position for discrete presentation of Foundation		(23,390)
Net position, as of February 28, 2011 as restated	$	768,761

(3) Net Patient Service Revenue

Charity care provided during the years ended February 28, 2013 and February 29, 2012, measured at established rates, totaled $1,346,091,000 and $1,254,491,000, respectively. These charges are not included in 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 28, 2010.

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, 2008.

Cash received from the Medicare program accounted for approximately 27% and 26% of the System's total cash collections for net patient service revenue for the years ended February 28, 2013 and February 29, 2012, respectively. Cash received from the Medicaid program (including managed Medicaid) accounted for approximately 54% and 54% of the System's total cash collections for net patient service revenue for the years ended February 28, 2013 and February 29, 2012.

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. According to the DSH program guidelines, the System may use the funds for the benefit of the indigent in either the immediate period or future periods.

The Upper Payment Limit (UPL) program was created in May 2002 with an effective date of July 2001. The UPL program uses federal matching funds to raise state Medicaid reimbursement rates to 100% of equivalent Medicare rates for certain public hospital systems.

The System recognizes all funds received under the DSH and UPL 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 balance sheet. These receivables can be subject to adjustments that are reflected in the period they become known. There were no adjustments recorded in fiscal 2013 and 2012 for prior years programs.

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 funding, combined with cost savings from the expansion, provides incentive payments for healthcare improvements and directs more funding to hospitals that serve large numbers of uninsured patients. The System had recorded a receivable of $193.0 and $96.4 million at February 28, 2013 and February 29, 2012, respectively, related to the DSH and 1115 Waiver programs.

(Continued)

(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 28, 2013 and February 29, 2012. The components of assets limited as to use or restricted at fair value at February 28, 2013 and February 29, 2012, are as follows (in thousands):

	2013					
				Designated		
Description of assets	Total	Restricted debt service	Restricted/ designated capital expansion	Legal reserves	Self-insured programs	Other
Money market government funds	$ 2,134	327	—	1,778	—	29
Government securities	359,650	30,440	149,060	546	178,764	840
	361,784	30,767	149,060	2,324	178,764	869
Less funds required for current liabilities	(39,611)	(5,608)	(9,504)	(2,324)	(22,175)	—
	$ 322,173	25,159	139,556	—	156,589	869

	2012					
				Designated		
Description of assets	Total	Restricted debt service	Restricted/ designated capital expansion	Legal reserves	Self-Insured programs	Other
Money market government funds	$ 37,118	6,719	23,214	2,192	4,943	50
Government securities	366,148	18,404	197,222	—	149,684	838
	403,266	25,123	220,436	2,192	154,627	888
Less funds required for current liabilities	(37,847)	(5,380)	(11,279)	(2,192)	(18,996)	—
	$ 365,419	19,743	209,157	—	135,631	888

Foundation – Assets limited as to use of \$14.7 million and \$22.2 million at February 28, 2013 and February 29, 2012, 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 describe 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.

(Continued)

The table below indicates the fair value and maturity amount of the System's investments as of February 28, 2013 and February 29, 2012 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).

	2013				
Security	**Fair value**	**Percentage of portfolio**	**Maturity amount**	**Modified duration (years)**	**Credit Rating S&P/ Rating Moody's**
Commercial paper:					
FCAR Owner Trust	$ 838	0.13%	$ 838	0.090	A-1+
TMCC	249,511	37.39	249,895	0.364	A-1+
Other:					
Maryland State	3,017	0.45	3,000	0.507	AA+
King County Washington	11,247	1.69	10,000	15.767	AAA/Aa3
San Antonio Texas Electric and Gas	1,349	0.20	1,190	18.937	AA
Marian & Polk Ctys Ore School	1,281	0.19	1,280	2.293	Aa1
U.S. agency notes:					
FHLB	80,021	11.99	80,000	2.381	AAA/Aaa
FHLMC	20,004	3.00	20,000	2.573	AAA/AA+
FFCB	30,005	4.50	30,000	3.025	AA+
FNMA	193,286	28.96	193,277	3.198	AAA/AA+
Money market mutual funds	76,847	11.50	76,847	—	AAA/Aaa
Total cash and investments	$ 667,406	100.00%	$ 666,327	1.875	

	2012				
Security	**Fair value**	**Percentage of portfolio**	**Maturity amount**	**Modified duration (years)**	**Credit Rating S&P/ Rating Moody's**
Commercial paper:					
TMCC	$ 239,513	32.00%	$ 240,838	1.000	A-1+
Other:					
Maryland State	8,862	1.00	8,820	1.000	AA+
King County Washington	11,307	2.00	10,000	17.000	AAA
San Antonio Texas Electric and Gas	1,303	—	1,190	20.000	AA
U.S. agency notes:					
FHLB	7,547	1.00	7,547	4.000	AAA/Aaa
FHLMC	55,014	7.00	55,000	3.000	AAA/Aaa

Security	2012 Fair value	Percentage of portfolio	Maturity amount	Modified duration (years)	Credit Rating S&P/ Rating Moody's
FNMA	$ 147,747	20.00%	$ 147,515	4.000	AAA/Aaa
Money market mutual funds	274,607	37.00	274,607	—	AAA/Aaa
Total cash and investments	$ 745,900	100.00%	$ 745,517	1.000	

The System maintained no investments in derivatives at February 28, 2013 and February 29, 2012.

The table below indicates the fair value and maturity amount of the HMO's investments as of December 31, 2012 and 2011 summarized by security type. Also demonstrated are the percentage of total portfolio and the modified duration in years for each summarized security type (in thousands).

Security	2012 Fair value	Percentage of portfolio	Maturity amount	Modified duration (years)	Credit Rating S&P/ Rating Moody's
Commercial paper:					
TMCC	$ 104,771	67.67%	$ 105,000	0.438	A-1+
Other:					
North Texas Tollway Authority	14,700	9.50	14,500	0.668	AAA
U.S. agency notes:					
FHLMC	15,002	9.69	15,000	2.521	AAA
Time deposit:					
JP Morgan Chase	3,323	2.15	3,323	0.410	AAA
Money market mutual funds	17,026	10.99	17,026	—	AAA
Total cash and investments	$ 154,822	100.00%	$ 154,849	0.615	

	2011				
Security	**Fair value**	**Percentage of portfolio**	**Maturity amount**	**Modified duration (years)**	**Credit Rating S&P/ Rating Moody's**
Commercial paper:					
TMCC	$ 34,770	21.00%	$ 35,000	1.000	A-1+
Other:					
North Texas Tollway Authority	14,846	9.00	14,500	2.000	AAA
U.S. agency notes:					
FHLB	35,245	21.00	35,250	3.000	AAA/Aaa
FFCB	15,000	9.00	15,000	4.000	AAA/Aaa
FNMA	50,028	30.00	50,000	3.000	AAA/Aaa
Time deposit:					
JP Morgan Chase	3,323	2.00	3,323	—	AAA/Aaa
Money market mutual funds	13,009	8.00	13,009	—	AAA/Aaa
Total cash and investments	$ 166,221	100.00%	$ 166,082	2.000	

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

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

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

At February 28, 2013 and February 29, 2012, the carrying amount of the HMO's demand and time deposits was $3.3 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 28, 2013 and February 29, 2012, 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 28, 2013 and February 29, 2012, consists of the following (in thousands):

	2013			
	Beginning balance	**Additions/ transfers**	**Retirements**	**Ending balance**
Land and improvements	$ 37,280	1,967	(147)	39,100
Buildings and fixed equipment	406,023	71,929	(185)	477,767
Major movable equipment	273,285	54,600	(16,495)	311,390
Total at historical cost	716,588	128,496	(16,827)	828,257
Less accumulated depreciation:				
Land and improvements	(6,221)	(995)	53	(7,163)
Buildings and fixed equipment	(235,742)	(14,638)	82	(250,298)
Major moveable equipment	(188,615)	(35,742)	14,015	(210,342)
Total accumulated depreciation	(430,578)	(51,375)	14,150	(467,803)
Construction in progress	74,366	(9,436)	—	64,930
Capital assets – net	$ 360,376	67,685	(2,677)	425,384

		2012			
		Beginning balance	Additions/ transfers	Retirements	Ending balance
Land and improvements	$	36,631	654	(5)	37,280
Buildings and fixed equipment		391,667	16,405	(2,049)	406,023
Major movable equipment		260,462	25,405	(12,582)	273,285
Total at historical cost		688,760	42,464	(14,636)	716,588
Less accumulated depreciation:					
Land and improvements		(5,235)	(986)	—	(6,221)
Buildings and fixed equipment		(224,813)	(12,894)	1,965	(235,742)
Major moveable equipment		(167,998)	(32,969)	12,352	(188,615)
Total accumulated depreciation		(398,046)	(46,849)	14,317	(430,578)
Construction in progress		27,522	46,844	—	74,366
Capital assets – net	$	318,236	42,459	(319)	360,376

Depreciation expense for the years ended February 28, 2013 and February 29, 2012 was $51,375,000 and $46,849,000, 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 long-term debt net of unamortized deferred amounts of $16,983,000 and $19,221,000 at February 28, 2013 and February 29, 2012, respectively. Principal amounts of total defeased indebtedness outstanding at February 28, 2013 and February 29, 2012 are $148,785,000 and $168,470,000, respectively. The bonds are secured by an irrevocable letter of credit issued by JPMorgan Chase Bank.

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

Under an irrevocable letter of credit issued by JPMorgan Chase Bank, only the tender agent is entitled to draw an amount sufficient to pay the principal amount of the bonds when due, or to pay the portion of the purchase price corresponding to the principal amount upon certain tenders. The letter of credit is valid through August 12, 2013. 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 0.75% per annum of the outstanding principal amount of the bonds. No amounts were outstanding on the letter of credit as of February 28, 2013 and February 29, 2012. In addition, the System is required to pay the remarketing agent an annual fee of $1.00 per $1,000 of principal amount of the bonds actually remarketed.

Compliance

The System is in compliance with its debt covenants at February 28, 2013 and February 29, 2012.

(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, 2024
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 highly 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 ($10.1) million and ($10.9) million at February 28, 2013 and February 29, 2012, 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 swaps agreements decrease the System's net payment in the swap agreement could increase.

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

Collateral Posting Risk – The risk that the System will be required to secure its obligations under the swap agreement. Any securities posted as collateral would not be available for the System's expenditure or reserve needs, which could adversely impact credit ratings and overall liquidity and budgetary efforts. The System was not exposed to collateral posting risk as of and for the years ended February 28, 2013 and February 29, 2012.

Credit Risk – The risk of a change in the credit quality or credit rating of the System and/or its counterparty. As of February 28, 2013, the swap counterparty was rated A+ by Standard & Poor's and A2 by Moody's Investors Services. The swap counterparty was rated A+ by Standard & Poor's and Aa3 by Moody's Investors Services as of February 29, 2012. At February 28, 2013 and February 29, 2012 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 28, 2013 and February 29, 2012, the System was not exposed to rollover risk.

Termination Risk – The System's swap agreements do not contain any out-of-the-ordinary termination events that would expose it to significant termination risk. In keeping with market standards, the System or the counterparty may terminate each swap if the other party fails to perform under the terms of the contract. In addition, the swap documents allow either party to terminate in the event of a significant loss of creditworthiness. If at the time of the termination a swap has a negative value, the System would be liable to the counterparty for a payment equal to the fair value of such swap. As of February 28, 2013 and February 29, 2012, termination of the original swap agreement would create a liability of $27.0 million and $28.6 million, respectively, and would result in a reversal of the derivative liability related to the redesignated swap, the borrowing payable amount, and the deferred loss on refunding. Any resulting net change would be recorded through nonoperating expenses.

Swap Payments – Using interest rates as of February 28, 2013, 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.

		Principal	Interest	Swap	Total
Years ending February:					
2014	$	4,985	14,081	(2,905)	16,161
2015		5,195	13,846	(2,851)	16,190
2016		5,415	13,602	(2,795)	16,222
2017		5,635	13,347	(2,736)	16,246
2018		5,870	13,082	(2,676)	16,276
2019–2023		33,590	61,005	(12,379)	82,216
2024–2028		42,255	52,270	(10,440)	84,085
2029–2033		53,395	41,068	(8,063)	86,400
2034–2038		67,510	26,774	(5,163)	89,121
2039–2042		66,990	8,469	(1,605)	73,854
Total		290,840	257,544	(51,613)	496,771
Less – unamortized deferred loss on refunding on 2010 revenue bonds		(16,983)	—	—	(16,983)
Total	$	273,857	257,544	(51,613)	479,788

Using interest rates as of February 29, 2012, 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.

		Principal	Interest	Swap	Total
Years ending February:					
2013	$	4,775	14,305	(2,962)	16,118
2014		4,985	14,081	(2,911)	16,155
2015		5,195	13,846	(2,856)	16,185
2016		5,415	13,602	(2,800)	16,217
2017		5,635	13,347	(2,742)	16,240
2018–2022		32,120	62,518	(12,748)	81,890
2023–2027		40,330	54,201	(10,881)	83,650
2028–2032		50,965	43,519	(8,594)	85,890
2033–2037		64,355	29,929	(5,800)	88,484

		Principal	Interest	Swap	Total
2038–2042	$	81,840	12,501	(2,383)	91,958
Total		295,615	271,849	(54,677)	512,787
Less – unamortized deferred loss on refunding on 2010 revenue bonds		(19,221)	—	—	(19,221)
Total	$	276,394	271,849	(54,677)	493,566

Hybrid Instrument Borrowings – The System’s interest rate swap includes fixed rates that were off market at the execution of the interest rate swap. For financial reporting purposes, the interest rate swap is considered a hybrid instrument and is bifurcated between borrowings, with an aggregate original amount of $18 million reflecting the fair value of the instrument at its execution, and an interest rate swap with a fixed rate that was considered at the market at execution. Activity for the hybrid instrument borrowings for the years ended February 28, 2013 and February 29, 2012 was as follows (in thousands):

		2013	2012
Beginning balance	$	16,159	17,546
Additions		—	—
Reductions		(879)	(1,387)
Ending balance	$	15,280	16,159

The following table sets forth as of February 28, 2013 and February 29, 2012, the amortization of the hybrid instrument borrowings for the next five years and thereafter (in thousands).

Years ending February:		February 28, 2013	Years ending February:	February 29, 2012
2014	$	863	2013	879
2015		846	2014	863
2016		828	2015	846
2017		811	2016	828
2018		792	2017	811
2019–2023		3,662	2018-2022	3,765
2024–2028		3,089	2023-2027	3,213
2029–2033		2,386	2028-2032	2,538
2034–2038		1,527	2033-2037	1,713
2039–2042		476	2038-2042	703
Total	$	15,280		16,159

(Continued)

(c) Other Obligations

Other long-term obligations at February 28, 2013 and February 29, 2012, are as follows (in thousands):

		2013		
		Principal	**Interest**	**Total**
Years ending February:				
2014	$	892	28	920
2015		106	3	109
2016		38	1	39
2017		5	—	5
Total	$	1,041	32	1,073

		2012		
		Principal	**Interest**	**Total**
Years ending February:				
2013	$	1,778	156	1,934
2014		1,184	69	1,253
2015		435	32	467
2016		346	17	363
2017		185	3	188
Total	$	3,928	277	4,205

(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 pension plan to freeze 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) (401k 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 $17,000 during calendar year 2012 and $16,500 during calendar year 2011 for all participants. Contributions to the plan cannot exceed the statutory maximum of $22,500 during calendar year 2012 and $22,000 during calendar year 2011 for participants age 50 and older. Effective July 2007, the System enhanced the 401k 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 401k 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 $20,819,000 and $18,787,000 in fiscal years 2013 and 2012, respectively. Total System contributions were $5,893,000 and $4,940,000 in fiscal years 2013 and 2012, 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 projected unit credit method is used to determine both the funding.

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.

(c) 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, 2013	$	27,537,225	100%	$	2,284,009
February 29, 2012		23,709,066	100		2,335,034

The Plan is on a calendar year-end, and for the plan year ended December 31, 2012, the actuarially determined contribution requirement was approximately $27,486,000 and intended to cover normal cost of $13,526,258 and $11,923,927 for amortization of the unfunded actuarial accrued liability and represented 12.0% of January 1, 2012, covered payroll.

During the year ended February 28, 2013, the System made cash contributions of $27,486,200 to the pension trust. Pension expense recognized in the statements of revenues, expenses, and changes in net position was $27,537,000.

During the year ended February 29, 2012, the System made cash contributions of $23,657,000 to the pension trust. Pension expense recognized in the statements of revenues, expenses, and changes in net position was $23,709,000.

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 years were as follows:

		2013	2012
Annual required contribution	$	27,486,200	23,656,901
Interest discount on net pension asset		(186,803)	(190,976)
Adjustment to annual required contribution		237,828	243,141
Annual pension cost		27,537,225	23,709,066
Contributions made		27,486,200	23,656,901
Decrease in net pension asset		(51,025)	(52,165)
Net pension asset – beginning of year		2,335,034	2,387,199
Net pension asset – end of year	$	2,284,009	2,335,034

As of January 1, 2012, the most recent actuarial valuation date, the Plan was 78.1% funded. The actuarial accrued liability for benefits was $576,557,000, and the actuarial value of assets was

$450,121,000, resulting in an unfunded actuarial accrued liability (UAAL) of $126,436,540. The covered payroll (annual payroll of active employees covered by the Plan) was $229,055,944, and the ratio of the UAAL to the covered payroll was 55.2%.

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 are increasing or decreasing over time relative to the actuarial accrued liability for benefits.

Actuarial methods and assumptions used in the January 1, 2012 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)	8.0%
Projected salary increases (ultimate rate)	4.0%
Mortality rates	The RP2000 Combined Mortality Tables

(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 28, 2013 and February 29, 2012 were approximately $77,753,007 and $72,109,000, 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 retirees and beneficiaries eligible to receive the benefits was 2,332 and 2,219 at January 1, 2012 and 2011, respectively.

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 2013 and 2012, the System contributed $18 million and $15 million, respectively, to the Plan for current premiums and administrative costs. Plan members receiving benefits during fiscal year 2013 and 2012 contributed $2 million, or approximately 14% of the total premiums, through their required contribution of $54.15 per month for retiree-only coverage and $386.60 for retiree and spouse coverage.

The System's annual OPEB cost or expense is calculated based on the annual required contribution of the System (ARC), an amount actuarially determined in accordance with GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions*. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities, or funding excess, over a period not to exceed 30 years. The following table shows the components of the System's annual OPEB cost for the years 2013 and 2012, the amount actually contributed to the Plan, and changes in the System's net OPEB obligation to the Plan (in thousands):

		2013	2012
Annual required contribution	$	38,075	49,290
Interest on net OPEB obligation		5,889	4,439
Adjustment to annual required contribution		(6,130)	(4,621)
Annual OPEB cost/expense		37,834	49,108
Contributions		15,176	12,856

		2013	2012
Increase in net OPEB obligation	$	22,658	36,252
Net OPEB obligation – beginning of year		147,231	110,979
Net OPEB obligation – end of year	$	169,889	147,231

The System annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for 2013 and 2012 were as follows (in thousands):

		2013			
Fiscal Year		Annual OPEB cost	Percentage of OPEB contributed		Net OPEB obligation
2013	$	37,834	40%	$	169,889
2012		49,108	26		147,231

Effective June 1, 2012 Plan changes were made to the eligibility requirements standard and to premium cost sharing requirements for early retirees resulting in cost savings to the System.

As of the March 1, 2012 and 2011 actuarial valuations, the Plan was not prefunded. Contributions made were for current-year costs incurred only. The actuarially accrued liability for benefits was $566.6 million and $548.8 million for March 1, 2012 and 2011, respectively, and the actuarial value

(Continued)

of assets was $0 resulting in an unfunded actuarial accrued liability of $566.6 million and $548.8 million for March 1, 2012 and 2011, respectively. The covered payroll (annual payroll of active employees covered by the Plan) was $229.1 million and $241.1 million for March 1, 2012 and 2011, respectively. The ratio of the unfunded actuarial accrued liability to the covered payroll was 247.4% and 227.7% for March 1, 2012 and 2011, respectively.

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

In the March 1, 2012 and 2011 actuarial valuations, the projected unit credit actuarial cost method was used. The actuarial assumptions included a 4% investment rate of return and an annual healthcare cost trend rate of 7.0% 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.

(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 District's combined financial statements net of charges for charity care provided. The mix of net receivables from self-pay patients and third-party payors at February 28, 2013 and February 29, 2012 is as follows:

	2013	2012
Medicaid	29%	28%
Medicare	19	14
Commercial	9	8
Self-pay patient	43	50
	100%	100%

(11) Commitments and Contingencies

At February 28, 2013 and February 29, 2012, 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, 2012, that may result in the assertion of additional claims. The System covers its exposure for asserted and unasserted claims through a program of self-insurance and has accrued its best estimate of these contingent losses. In the opinion of the System's management, the outcomes of these actions will not have a material adverse effect on the financial statements of the System.

The System has self-insurance programs for the payment of hospital professional and general liability claims, workers' compensation, and employee health claims. Liabilities related to these programs are accrued utilizing actuarial analyses based on historical claims experience and are undiscounted. Changes in these self-insurance programs for the years ended February 28, 2013 and February 29, 2012 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:					
2013	$	2,352	389	160	2,581
2012		3,409	(656)	401	2,352
Workers' compensation liability:					
2013		1,936	2,296	1,794	2,438
2012		2,726	415	1,205	1,936
Employee healthcare benefits liability:					
2013		7,396	84,259	82,780	8,875
2012		7,340	70,396	70,340	7,396

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 balance sheet. 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 28, 2013, the System had commitments outstanding in the amount of approximately $13.3 million related to construction of new facilities, $30.5 million related to improvements at existing facilities, and $4.0 million related to information technology projects.

At February 29, 2012, the System had commitments outstanding in the amount of approximately $20.3 million related to construction of new facilities, $30.7 million related to improvements at existing facilities, and $5.6 million related to information technology projects.

The System had rental expenses related to its operating leases of approximately $7,577,000 and $6,662,000 during the years ended February 28, 2013 and February 29, 2012.

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 district. 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 County Hospital District and the Affiliated Hospitals – Gulf Coast Division Inc., Memorial Hermann Hospital System, CHRISTUS Health Gulf Coast, St. Joseph Medical Center, the Methodist Hospital, Texas Children's 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.

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 District. 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 $222 million of physician and other clinical services annually to the indigent in the Harris County community. Under a management agreement between HCCS and the System, the System manages the services provided by AMS and provides facilities for indigent patients to receive services.

During the fiscal years ended February 28, 2013 and February 29, 2012, the System utilized $87.9 million and $151.8 million of tax revenues, respectively, as the nonfederal share of the Harris Collaborative program. The System recorded expenses of $153.3 million and $135.7 million in 2013 and 2012, 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.

(Continued)

(13) Subsequent Events

The System evaluated subsequent events from February 28, 2013 through June 20, 2013, 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 Funding Progress of Defined Benefit Pension Plan

Three-Year Historical Trend Beginning January 1, 2010

(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, 2010	$	438,597	527,930	89,333	83.1%	$	250,454	35.7%
January 1, 2011		449,247	540,947	91,700	83.0		241,076	38.0
January 1, 2012		450,121	576,557	126,436	78.1		229,056	55.2

Dollar amounts in thousands.

See accompanying independent auditors’ report.

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

Schedule of Actuarial Data for Defined Benefit Pension Plan

January 1, 2012

(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, 2012
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	8.0
Projected salary increases (ultimate rate)	4.0
Cost-of-living adjustments	Not applicable
Mortality rates	The RP2000 Combined Mortality Tables

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, 2010

(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, 2010	$ —	540,087	540,087	—%	$ 250,454	215.6%
March 1, 2011	—	548,818	548,818	—	241,076	227.7
March 1, 2012	—	566,614	566,614	—	229,056	247.4

Dollar amounts in thousands.

See accompanying independent auditors' report.