

**Harris County Hospital District,  
d/b/a Harris Health System,  
A Component Unit of Harris County, Texas**  
Independent Auditor's Report and Financial Statements  
February 28, 2019 and 2018



**Harris County Hospital District,  
d/b/a Harris Health System,  
A Component Unit of Harris County, Texas  
February 28, 2019 and 2018**

**Contents**

<b>Independent Auditors' Report .....</b>	<b>1</b>
<b>Management's Discussion and Analysis .....</b>	<b>4</b>
<b>Financial Statements</b>	
Statements of Net Position.....	13
Statements of Revenues, Expenses and Changes in Net Position.....	17
Statements of Cash Flows.....	18
Notes to Financial Statements.....	20
<b>Required Supplementary Information</b>	
Schedule of Changes in the System's Net Pension Liability and Related Ratios.....	57
Schedule of System Pension Contributions .....	58
Schedule of Changes in the System's Total OPEB Liability and Related Ratios.....	59

## Independent Auditors' Report

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

### Report on the Financial Statements

We have audited the accompanying financial statements of the business-type activities and the aggregate discretely presented component units of Harris County Hospital District, d/b/a Harris Health System (the System), collectively a component unit of Harris County, Texas, as of and for the year ended February 28, 2019 and 2018, and the related notes to the financial statements, which collectively comprise the System's basic financial statements as listed in the table of contents.

### *Management's Responsibility for the Financial Statements*

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

### *Auditor's Responsibility*

Our responsibility is to express opinions on these financial statements based on our audits. We did not audit the financial statements of the Harris County Hospital District Foundation (Foundation), a discretely presented component unit of the System, which represent 13.1 percent and 9.0 percent of total assets, 26.9 percent and 25.8 percent of net position and 0.2 percent and 0.2 percent of revenues, respectively of the aggregate discretely presented component units for the years ended February 28, 2019 and 2018. Those statements were audited by other auditors, whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for the Foundation, is based solely on the report of the other auditors. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement. The financial statements of the discretely presented component units, which are included in the System's financial statements, were not audited in accordance with *Government Auditing Standards*.

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

In making those risk assessments, the auditor considers internal control relevant to the System'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 System's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

### ***Opinions***

In our opinion, based on our audits and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities and the aggregate discretely presented component units of the System as of February 28, 2019 and 2018, and the respective changes in financial position and, where applicable, cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

### ***Emphasis of Matter***

As discussed in Note 2 to the financial statements, in 2019, the System adopted Governmental Accounting Standards Board Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*. Our opinions are not modified with respect to this matter.

### ***Required Supplementary Information***

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

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

Board of Trustees  
Harris County Hospital District,  
d/b/a Harris Health System  
Page 3

**Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated June 28, 2018, on our consideration of the System's internal control over financial reporting and 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 the effectiveness of the System's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the System's internal control over financial reporting and compliance.

*BKD, LLP*

Houston, Texas  
June 28, 2019

**Harris County Hospital District,  
d/b/a Harris Health System,  
A Component Unit of Harris County, Texas  
Management's Discussion and Analysis  
February 28, 2019 and 2018**

**Introduction**

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, 2019 and 2018. This section should be read in conjunction with the System's financial statements, which begin on page 13.

***Financial Highlights***

- The System's net position decreased approximately \$107 million (21.1 percent) in fiscal 2019 and \$22 million (4.2 percent) in fiscal 2018. Fiscal year 2019 includes \$131 million prior period adjustment for GASB 75 implementation relating to OPEB liability. In December 2017, the System contributed \$60 million to HMO, Community Health Choice, Inc., to provide additional risk-based capital for the calendar year ending December 31, 2017.
- The ad-valorem tax base increased approximately 3.0 percent and 4.0 percent in fiscal 2019 and fiscal 2018 respectively. The base rate for maintenance and operations remained constant at 17 cents per one hundred dollars of assessed value. The System's tax rate to fund debt service requirements for the Series 2016 Certificates of Obligation was adjusted slightly downward due to the rising valuation.
- During fiscal 2019 and 2018, the System invested \$85 million and \$70 million, respectively, in space/facility expansion projects, critical information technology and medical equipment. Significant capital acquisitions and resource investments included the following:
  - Semi-private room renovations at the Ben Taub campus and the LBJ campus are near completion. Operational beds decreased approximately 0.7 percent in fiscal 2019 and 3.4 percent in fiscal 2018.
  - Expansion of operating suites and supporting services to maintain Level I trauma services at Ben Taub Hospital is on-going. Construction, funded by the 2016 bond issue, is expected to be completed in late calendar 2019.
- The Community Health Choice HMOs (Community Health Choice Texas, Inc. - the Medicaid Managed Care HMO and Community Health Choice, Inc. - the Health Insurance Marketplace and commercial HMO) experienced a decrease of 9 percent in membership during fiscal 2019 and 17.8 percent growth in membership during fiscal 2018.

## Financial Statements

The System's financial statements are prepared on the accrual basis of accounting and present the System's operational activities in a manner similar to that of private sector companies. The financial statements consist of three statements: (1) statements of net position, (2) statements of revenues, expenses and changes in net position and (3) statements of cash flow. The statements provide information about the activities of the System, the Harris County Hospital District Foundation (the Foundation), and the Community Health Choice HMOs, which are reported as discretely presented component units. The statements of net position and the statements of revenues, expenses and changes in net position reflect the System's financial position at the end of the fiscal year and report the net position and changes as a result of the revenues and expenses for the year. The statement of net position presents the assets, deferred outflows, liabilities, deferred inflows and net position of the System at the end of the year. The net position section presents assets plus deferred outflows of resources, less liabilities, less deferred inflows of resources. Increases or decreases in net position are an indicator of whether financial health is improving or deteriorating. Other nonfinancial factors should be considered, however, in evaluating financial health, such as changes in the System's patient base, changes in economic conditions, taxable property values and tax rates, and changes in government legislation. The statement of cash flows reports cash receipts, cash payments, and net changes in cash resulting from operations, investing and noncapital/capital financing activities. The statement explains where cash came from, how it was used and the change in cash balance during the year.

## Net Position

**Table 1**  
**Condensed Statements of Net Position**  
**(In millions)**

	2019	2018	Dollar Change	Total Percentage Change	2017	Dollar Change	Total Percentage Change
<b>Assets</b>							
Current and other assets	\$ 1,064	\$ 1,066	\$ (2)	-0.2%	\$ 1,057	\$ 9	0.9%
Capital assets	466	436	30	6.9%	422	14	3.3%
Total assets	1,530	1,502	28	1.9%	1,479	23	1.6%
Deferred outflows of resources:							
Derivative financial instrument	8	6	2	33.3%	9	(3)	-33.3%
Resources related to pension	60	8	52	650.0%	36	(28)	-77.8%
Unamortized loss on refunding debt	10	10	-	0.0%	12	(2)	-16.7%
Total deferred outflows	78	24	54	225.0%	57	(33)	-57.9%
Total assets and deferred outflows	\$ 1,608	\$ 1,526	\$ 82	5.4%	\$ 1,536	\$ (10)	-0.7%
<b>Liabilities</b>							
Long-term debt outstanding	\$ 316	\$ 325	\$ (9)	-2.8%	\$ 335	\$ (10)	-3.0%
Current liabilities	165	158	7	4.4%	144	14	9.7%
Other liabilities	726	508	218	42.9%	524	(16)	-3.1%
Total liabilities	1,207	991	216	21.8%	1,003	(12)	-1.2%
Deferred inflows of resources:							
Resources related to pension	-	27	(27)	-100.0%	3	24	800.0%
Total deferred inflows	-	27	(27)	-100.0%	3	24	800.0%
Total liabilities and deferred inflows	\$ 1,207	\$ 1,018	\$ 189	18.6%	\$ 1,006	\$ 12	1.2%
Net investment in capital assets	\$ 179	\$ 164	\$ 15	9.1%	\$ 148	\$ 16	10.8%
Restricted	33	32	1	3.1%	24	8	33.3%
Unrestricted	189	312	(123)	-39.4%	358	(46)	-12.8%
Total net position	\$ 401	\$ 508	\$ (107)	-21.1%	\$ 530	\$ (22)	-4.2%

Total net position represents the residual interest in the System's assets and deferred outflows after liabilities and deferred inflows are deducted. As stated previously, net position decreased \$107 million (21.1 percent) and \$22 million (4.2 percent) in fiscal 2019 and 2018, respectively. Fiscal year 2019 includes \$131 million prior period adjustment for GASB 75 implementation relating to OPEB liability. The overall decrease in fiscal 2018 is the result of a \$60 million contribution to HMO, Community Health Choice Inc., to provide additional risk-based capital.

Total assets and deferred outflows of resources increased approximately \$82 million (5.4 percent) between fiscal 2018 and fiscal 2019 and decreased approximately \$10 million (0.7 percent) between fiscal 2017 and fiscal 2018.

- Current and other assets decreased 0.2 percent from fiscal 2018 to fiscal 2019 and increased 0.9 percent from fiscal 2017 to fiscal 2018.
- Capital assets are discussed in detail following Table 3.
- Deferred outflows of resources consist of the fair market value of derivatives, unamortized losses on refunding of debt and resources related to the System's pension plan. Deferred outflows related to pension increased \$52 million in fiscal 2019 and decreased \$28 million in fiscal 2018.

Total liabilities and deferred inflows of resources increased \$189 million (18.6 percent) and increased \$12 million (1.2 percent) in fiscal 2019 and 2018, respectively.

- In 2019 and 2018, reductions in bond-related debt reflect scheduled debt service payments. Long term debt, including current portion, decreased approximately \$9 million (2.8 percent) in fiscal 2019 and approximately \$10 million (3.0 percent) in fiscal 2018.
- Other liabilities increased \$218 million or 42.9 percent in fiscal 2019 and decreased \$16 million or 3.1 percent in fiscal 2018.
  - The System's net obligation for the provision of certain postemployment healthcare benefits increased approximately \$134 million in fiscal 2019 with \$131 million being due to GASB 75 implementation, and \$41 million in fiscal 2018.
  - The System's net pension liability increased approximately \$99 million in fiscal 2019 and decreased \$54 million in fiscal 2018, primarily due to change in net investment income and changes in actuarial assumptions.
- Deferred inflows of resources related to pension decreased \$27 million in fiscal 2019 and increased \$24 million in fiscal 2018.

### ***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, 2019, 2018 and 2017, 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)

	<b>2019</b>	<b>2018</b>	<b>2017</b>
<b>Operating Revenues</b>			
Net patient service revenue	\$ 477,758	\$ 402,551	\$ 390,180
Medicaid supplemental programs revenues	194,478	266,468	230,279
Other operating revenues	<u>27,147</u>	<u>27,143</u>	<u>29,508</u>
Total operating revenues	<u>699,383</u>	<u>696,162</u>	<u>649,967</u>
<b>Operating Expenses</b>			
Salaries, wages and benefits	760,390	756,589	729,721
Purchased services, supplies and other	616,352	574,661	538,991
Depreciation and amortization	<u>53,349</u>	<u>53,963</u>	<u>54,275</u>
Total operating expenses	<u>1,430,091</u>	<u>1,385,213</u>	<u>1,322,987</u>
<b>Operating Loss</b>	<u>\$ (730,708)</u>	<u>\$ (689,051)</u>	<u>\$ (673,020)</u>
<b>Nonoperating Revenues</b>			
Ad valorem tax revenues - net	\$ 739,022	\$ 717,017	\$ 698,819
Tobacco settlement revenues	15,248	13,424	7,847
Investment income	11,423	7,815	5,273
Other	<u>(97)</u>	<u>(453)</u>	<u>539</u>
Total nonoperating revenues	<u>765,596</u>	<u>737,803</u>	<u>712,478</u>
<b>Nonoperating Expenses</b>			
Interest expense	(11,168)	(11,280)	(14,956)
Contribution to HMO	<u>-</u>	<u>(60,000)</u>	<u>-</u>
Total nonoperating expenses	<u>(11,168)</u>	<u>(71,280)</u>	<u>(14,956)</u>
<b>Income (Loss) Before Capital Contributions</b>			
	23,720	(22,528)	24,502
Capital contributions	<u>769</u>	<u>169</u>	<u>-</u>
Change in net position	<u>24,489</u>	<u>(22,359)</u>	<u>24,502</u>
<b>Net Position - Beginning of Year, as Previously Stated</b>	507,935	530,294	505,792
Prior period adjustment	<u>(131,090)</u>	<u>-</u>	<u>-</u>
<b>Net Position - Beginning of Year, as Restated</b>	<u>376,845</u>	<u>530,294</u>	<u>505,792</u>
<b>Net Position - End of Year</b>	<u>\$ 401,334</u>	<u>\$ 507,935</u>	<u>\$ 530,294</u>

## **Operating Revenues**

Operating revenues increased \$3.2 million (0.5 percent) during the fiscal year ended February 28, 2019. During the year ended February 28, 2018, the System's total operating revenue increased \$46.2 million (7.1 percent).

- Net patient service revenue increased \$75.2 million in fiscal 2019 and \$12.4 million in fiscal 2018. The majority of the increase was attributed to a near \$50 million and \$21 million growth in fiscal 2019 and fiscal 2018, respectively, in Medicare disproportionate share (DSH) add-on payments. The change in the Medicare DSH was due to the phased-in adoption, by Centers for Medicare and Medicaid Services (CMS), of the Medicare Cost Report schedule S-10 charity care methodology. The revised calculations typically benefit large urban safety net hospitals.
- The System participates in the Uncompensated Care (UC) Pool, Medicaid Disproportionate Share (Medicaid DSH), Delivery System Reform Incentive Payment (DSRIP) Pool, Network Access Improvement Program (NAIP), Uniform Hospital Rate Increase Program (UHRIP) and Graduate Medical Education (GME) Medicaid supplement programs. The increases in net patient revenues in fiscal 2019 were offset by the \$72 million decline in the Medicaid supplemental programs. The decline in the Medicaid DSH and UC distribution was due to the settlement of the Children's hospitals' lawsuit and the elimination of certain commercial and Medicare payment offsets to Medicaid costs. In fiscal 2018, supplemental program revenue increased by \$36.2 million mostly due to late achievement of the DSRIP metrics.

## **Operating Expenses**

Total operating expenses increased \$44.9 million (3.2 percent) during the fiscal year ended February 28, 2019. During the year ended February 28, 2018, the System's total operating expenses increased \$62.2 million (4.7 percent).

- In fiscal 2019, System salaries and wages increased \$15.0 million (2.8 percent) as a result of an increase to the minimum wage and an average wage increase of 3.0 percent, adjusted for slight volume decreases. In fiscal 2018, salaries and wages increased \$21.7 million (4.2 percent) as a result of increases in staffing, approximately 1.1 percent and an average wage increase of 3.1 percent.
- Related benefits decreased \$11.2 million (5.2 percent) in fiscal 2019 primarily due to decreased post-retirement health benefits as a result of the benefit policy revisions enacted in September 2018. In fiscal 2018, benefits increased \$5.2 million (2.5 percent) due to increases in employee medical plan costs.
- Purchased services, supplies, and other operating expenses increased \$41.7 million (7.3 percent) in fiscal 2019, primarily as a result of an increase in physician services, medical insurance subsidies, and purchased clinical services. In fiscal 2018, the same category of expense increased \$35.7 million (6.6 percent) mainly due to inflation in physician services and remediation work related to water intrusion during Hurricane Harvey.

Overall, the System's operating loss increased 6.0 percent from 2018 to 2019 and increased 2.4 percent from 2017 to 2018 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 non-operating revenues.

## Non-operating Revenues (Expenses)

Non-operating revenues and expenses consist of revenues and expenses related to financing and investing types of activities, including grants and donations for activities not considered as operating activities, and include property tax revenue, investment income, tobacco settlement funds, interest expense, contribution to HMO, gains or losses on disposal of assets, and certain grants and donations. Tax revenues, net of related expenses, increased \$22.0 million or 3.1 percent, in fiscal 2019 and \$18.2 million, or 2.6 percent, in fiscal 2018. The System received approximately \$15.2 million and \$13.4 million in tobacco settlement revenue in fiscal year 2019 and 2018, respectively. The System contributed \$60 million to Community Health Choice, Inc., to provide additional risk-based capital for the calendar year ended December 31, 2017.

## Capital Assets and Debt Financing

During fiscal 2019 and 2018, the System invested \$85 million and \$70 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, 2019, 2018 and 2017:

**Table 3**  
**Changes in Capital Assets**  
**(In thousands)**

	2019	2018	Dollar change	Total percentage change	2017	Dollar change	Total percentage change
Land and improvements	\$ 45,435	\$ 43,096	\$ 2,339	5.4%	\$ 42,012	\$ 1,084	2.6%
Buildings and fixed equipment	659,640	641,490	18,150	2.8%	616,643	24,847	4.0%
Major movable equipment	387,639	365,114	22,525	6.2%	351,041	14,073	4.0%
Subtotal	1,092,714	1,049,700	43,014	4.1%	1,009,696	40,004	4.0%
Less accumulated depreciation	(688,486)	(647,193)	(41,293)	6.4%	(613,999)	(33,194)	5.4%
Construction in progress	62,068	33,459	28,609	85.5%	26,312	7,147	27.2%
Capital assets - net	\$ 466,296	\$ 435,966	\$ 30,330	7.0%	\$ 422,009	\$ 13,957	3.3%

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 2020 includes an investment of \$81.5 million in routine capital expenditures. The capital projects include \$22.0 million in information technology primarily dedicated to current system upgrades and technology refresh, \$14.2 million specific to medical capital, and \$40.2 million in renovations of current facilities.

The proposed capital budget of \$81.5 million does not include the Ben Taub Operating Room and Trauma Center project, which is funded separately by the \$62.8 million in Certificates of Obligation issued in 2016. Construction is underway and expected to be completed in late calendar 2019.

At February 28, 2019 and 2018, the System had \$238.8 million and \$244.7 million, respectively, in outstanding revenue bonds. Moody's has an underlying rating of A2, Fitch of AA, and Standard and Poor's has a rating of AA- on the revenue bond obligations. The debt is scheduled to be repaid in 2042. The debt is issued in the name of the Harris County Hospital District. Any issuance of debt requires the approval of the System's Board of Trustees and the Harris County Commissioners' Court.

An interest rate swap and derivative liability are associated with the Series 2010 refunding and revenue bonds. The fair value of the interest rate swap was reported as a derivative liability of \$7.9 million and \$6.4 million at February 28, 2019 and 2018, respectively. An off-market element associated with the swap is reported as a borrowing payable in the amount of \$10.4 million and \$11.1 million at February 28, 2019 and 2018, respectively.

Table 4 below summarizes the System's debt obligations at February 28, 2019, 2018 and 2017:

<b>Long-Term Debt Obligations (In thousands)</b>			
	<b>2019</b>	<b>2018</b>	<b>2017</b>
Series 2010 revenue bonds	\$ 87,325	\$ 89,595	\$ 91,790
Series 2016 revenue bonds	164,559	169,176	173,639
Series 2016 certificates of obligation	<u>63,551</u>	<u>66,389</u>	<u>69,166</u>
Total long-term debt and other long-term obligations	315,435	325,160	334,595
Less current portion	<u>(8,546)</u>	<u>(8,180)</u>	<u>(7,817)</u>
Noncurrent portion	<u>\$ 306,889</u>	<u>\$ 316,980</u>	<u>\$ 326,778</u>

### ***Economic Conditions and Plan for Fiscal 2020***

While the health care environment at the national and state levels remains challenging, management does not expect any significant changes to Harris Health System's operations occurring within the next twelve months. In fiscal 2020, Harris Health System continues the focus on improving the health of those most in need in Harris County through high quality care, and positioning Harris Health to success in an uncertain healthcare environment.

We anticipate that the number of individuals who receive patient care from the System will remain steady for fiscal 2020. The demand for services by the uninsured population of Harris County continues to outpace existing capacity and resources. Harris Health System has implemented several service enhancement strategies over the past several years, increasing access to primary and specialty care, providing Marketplace insurance coverage for qualified indigent patients, and coordinating care opportunities with community partners. However, increases in resources are barely keeping pace with the inflation (about \$50 million annually). Although growth in new patient revenue is expected, primarily due to an increase in Medicare Disproportionate Share add-on payments, the increase will only be enough to offset inflation in labor, supplies and services costs. After accounting for inflationary increases, Harris Health is choosing to strategically invest its few remaining incremental resources in fiscal 2020. Such priority initiatives include expansion of outside medical services for the indigent, population health and addition of inpatient clinical capacity at Ben Taub and LBJ Hospitals.

Based upon assumptions regarding revenue and service projections, management is anticipating an operating margin of \$22.6 million which, is 1.5 percent of total projected revenues, for fiscal 2020 budget. The capital budget of \$81.5 million underlines the ongoing effort to manage operations and to be able to reinvest in the infrastructure of the System. Management projects a stable cash flow performance for fiscal 2020 and maintenance of the required day's cash on hand under the Harris Health System revenue bond covenants.

### ***Contacting the System's Financial Management***

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

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

**Statements of Net Position**  
**February 28, 2019 and 2018**  
**(In thousands)**

Assets and Deferred Outflows of Resources	2019				2018			
	Component Units				Component Units			
	Harris Health System	Foundation	Community Health Choice, Inc.	Community Health Choice Texas, Inc.	Harris Health System	Foundation	Community Health Choice, Inc.	Community Health Choice Texas, Inc.
<b>Current Assets</b>								
Cash and cash equivalents	\$ 343,522	\$ 231	\$ 103,549	\$ 130,642	\$ 210,046	\$ 263	\$ 225,827	\$ 51,718
Short-term investments (Notes 5 and 6)	397,466	-	30,363	15,411	495,382	-	6,524	15,594
Accounts receivable – net of allowance for uncollectible accounts of \$65,111 and \$85,111 (Note 10)	78,814	-	-	-	66,412	-	-	-
Current portion of ad valorem taxes receivable – net of allowance for uncollectible taxes of \$7,507 and \$7,309	31,049	-	-	-	35,366	-	-	-
Inventories	7,991	-	-	-	9,939	-	-	-
Medicaid supplemental programs receivable	35,268	-	-	-	22,080	-	-	-
Prepaid expenses and other current assets	28,470	1,114	37,595	26,230	11,417	788	29,900	21,490
Estimated third-party payor settlements	29,821	-	-	-	10,328	-	-	-
Due from Community Health Choice, Inc.	9,117	-	-	-	10,252	-	-	41,256
Due from Community Health Choice Texas, Inc.	-	-	7,925	-	-	-	-	-
Current portion of assets limited as to use or restricted (Notes 5 and 6)	6,595	-	-	-	6,352	-	-	-
<b>Total current assets</b>	<b>968,113</b>	<b>1,345</b>	<b>179,432</b>	<b>172,283</b>	<b>877,574</b>	<b>1,051</b>	<b>262,251</b>	<b>130,058</b>
<b>Assets Limited as to Use or Restricted – Net of Current Portion (Notes 5 and 6)</b>								
Debt service	25,098	-	-	-	24,751	-	-	-
BT level I trauma	29,349	-	-	-	53,181	-	-	-
Cash on deposit with county - project management	39,887	-	-	-	59,479	-	-	-
Other	840	44,664	3,325	600	813	29,186	3,325	600
<b>Total assets limited as to use or restricted – net</b>	<b>95,174</b>	<b>44,664</b>	<b>3,325</b>	<b>600</b>	<b>138,224</b>	<b>29,186</b>	<b>3,325</b>	<b>600</b>

**Harris County Hospital District,  
d/b/a Harris Health System,  
A Component Unit of Harris County, Texas**  
**Statements of Net Position (Continued)**  
**February 28, 2019 and 2018**  
**(In thousands)**

<b>Assets and Deferred Outflows of Resources (Continued)</b>	2019				2018			
	Component Units				Component Units			
	Harris Health System	Foundation	Community Health Choice, Inc.	Community Health Choice Texas, Inc.	Harris Health System	Foundation	Community Health Choice, Inc.	Community Health Choice Texas, Inc.
<b>Capital Assets (Notes 7 and 11)</b>								
Land and improvements	\$ 45,435	\$ -	\$ -	\$ -	\$ 43,096	\$ -	\$ -	\$ -
Buildings and fixed equipment	659,640	-	-	-	641,490	-	-	-
Major movable equipment	387,639	-	-	-	365,114	-	-	-
Less accumulated depreciation	(688,486)	-	-	-	(647,193)	-	-	-
Total depreciable capital assets – net	404,228	-	-	-	402,507	-	-	-
Construction in progress	62,068	-	-	-	33,459	-	-	-
Capital assets – net	466,296	-	-	-	435,966	-	-	-
<b>Other Assets</b>								
Ad valorem taxes receivable – net of current portion and allowance for uncollectible taxes of \$34,673 and \$36,399	276	-	-	-	428	-	-	-
Long-term investments (Note 6)	-	-	1,557	15,037	49,902	-	1,535	14,879
Other assets	66	10,316	-	-	66	10,649	-	-
Total other assets	342	10,316	1,557	15,037	50,396	10,649	1,535	14,879
<b>Deferred Outflows of Resources</b>								
Derivative financial instrument	7,918	-	-	-	6,437	-	-	-
Resources related to pension	60,122	-	-	-	7,641	-	-	-
Loss on refunding revenue bonds	9,588	-	-	-	10,304	-	-	-
Total deferred outflows of resources	77,628	-	-	-	24,382	-	-	-
Total assets and deferred outflows of resources	\$ 1,607,553	\$ 56,325	\$ 184,314	\$ 187,920	\$ 1,526,542	\$ 40,886	\$ 267,111	\$ 145,537

**Harris County Hospital District,  
d/b/a Harris Health System,  
A Component Unit of Harris County, Texas**  
**Statements of Net Position (Continued)**  
**February 28, 2019 and 2018**  
**(In thousands)**

Liabilities, Deferred Inflows of Resources and Net Position	2019				2018			
	Component Units				Component Units			
	Harris Health System	Foundation	Community Health Choice, Inc.	Community Health Choice Texas, Inc.	Harris Health System	Foundation	Community Health Choice, Inc.	Community Health Choice Texas, Inc.
<b>Current Liabilities</b>								
Accounts payable and accrued liabilities	\$ 71,539	\$ 56	\$ 30,899	\$ 2,900	\$ 69,197	\$ 656	\$ 29,963	\$ 1,575
Interest payable	528	-	-	-	545	-	-	-
Employee compensation and related benefit liabilities (Note 12)	32,825	-	-	-	30,333	-	-	-
Postemployment health benefit liability (Note 10)	16,228	-	-	-	-	-	-	-
Compensated absences	35,249	-	-	-	36,753	-	-	-
Medicaid supplemental programs payable	1,738	-	-	-	14,400	-	-	-
Medical claims liability (Note 2)	-	-	62,774	87,175	-	-	67,805	91,098
Liabilities related to the Affordable Care Act	-	-	16,998	-	-	-	53,889	-
Due to Harris Health System	-	-	10,462	-	-	-	11,472	-
Due to Community Health Choice Texas, Inc.	-	-	-	-	-	-	41,256	-
Due to Community Health Choice, Inc.	-	-	-	7,925	-	-	-	-
Estimated third-party payor settlements	6,210	-	-	-	7,056	-	-	-
Current portion of long-term debt and capital leases (Note 8)	8,546	-	-	-	8,180	-	-	-
<b>Total current liabilities</b>	<b>172,863</b>	<b>56</b>	<b>121,133</b>	<b>98,000</b>	<b>166,464</b>	<b>656</b>	<b>204,385</b>	<b>92,673</b>
<b>Other Long-Term Liabilities</b>								
Postemployment health benefit liability (Note 10)	428,093	-	-	-	309,838	-	-	-
Net pension liability (Note 9)	279,900	-	-	-	180,493	-	-	-
Borrowing payable (Note 8)	10,366	-	-	-	11,139	-	-	-
Derivative liability	7,918	-	-	-	6,437	-	-	-
Other	16	-	-	-	39	-	-	-
<b>Long-Term Debt (Note 8)</b>								
Series 2010 refunding revenue bonds	84,975	-	-	-	87,325	-	-	-
Series 2016 refunding revenue bonds - including premium of \$13,119	160,734	-	-	-	165,531	-	-	-
Series 2016 certificates of obligation - including premium of \$6,251	61,256	-	-	-	64,199	-	-	-
Other long-term obligations - capital leases	98	-	-	-	174	-	-	-
<b>Total liabilities</b>	<b>1,206,219</b>	<b>56</b>	<b>121,133</b>	<b>98,000</b>	<b>991,639</b>	<b>656</b>	<b>204,385</b>	<b>92,673</b>

**Harris County Hospital District,  
d/b/a Harris Health System,  
A Component Unit of Harris County, Texas**  
**Statements of Net Position (Continued)**  
**February 28, 2019 and 2018**  
**(In thousands)**

Liabilities, Deferred Inflows of Resources and Net Position (Continued)	2019				2018			
	Component Units				Component Units			
	Harris Health System	Foundation	Community Health Choice, Inc.	Community Health Choice Texas, Inc.	Harris Health System	Foundation	Community Health Choice, Inc.	Community Health Choice Texas, Inc.
<b>Deferred Inflows of Resources</b>								
Resources related to pension	\$ -	\$ -	\$ -	\$ -	\$ 26,968	\$ -	\$ -	\$ -
<b>Commitments and Contingencies (Note 12)</b>								
<b>Net Position</b>								
Net investment in capital assets	179,258	-	-	-	164,012	-	-	-
Restricted for debt service	32,532	-	-	-	31,916	-	-	-
Restricted – other	-	29,340	3,325	600	-	27,210	3,325	600
Unrestricted	189,544	26,929	59,856	89,320	312,007	13,020	59,401	52,264
Total net position	401,334	56,269	63,181	89,920	507,935	40,230	62,726	52,864
Total liabilities, deferred inflows of resources and net position	\$ 1,607,553	\$ 56,325	\$ 184,314	\$ 187,920	\$ 1,526,542	\$ 40,886	\$ 267,111	\$ 145,537

**Harris County Hospital District,  
d/b/a Harris Health System,  
A Component Unit of Harris County, Texas**  
**Statements of Revenues, Expenses and Changes in Net Position**  
**Years Ended February 28, 2019 and 2018**  
**(In thousands)**

	2019				2018			
	Component Units				Component Units			
	Harris Health System	Foundation	Community Health Choice, Inc.	Community Health Choice Texas, Inc.	Harris Health System	Foundation	Community Health Choice, Inc.	Community Health Choice Texas, Inc.
<b>Operating Revenues</b>								
Net patient service revenue (Note 3)	\$ 477,758	\$ -	\$ -	\$ -	\$ 402,551	\$ -	\$ -	\$ -
Medicaid supplemental programs revenue (Note 4)	194,478	-	-	-	266,468	-	-	-
Premium revenue	-	-	711,477	959,876	-	-	825,055	688,311
Other operating revenues	27,147	4,049	4,769	-	27,143	2,672	7,479	14
Total operating revenues	<u>699,383</u>	<u>4,049</u>	<u>716,246</u>	<u>959,876</u>	<u>696,162</u>	<u>2,672</u>	<u>832,534</u>	<u>688,325</u>
<b>Operating Expenses</b>								
Salaries, wages, and benefits	760,390	508	27,607	36,722	756,589	486	35,762	27,192
Pharmaceuticals and supplies	208,366	13	2,188	3,134	202,161	14	1,712	1,523
Physician services (Note 12)	250,863	-	-	-	237,178	-	-	-
Medical claims expense	-	-	579,523	879,355	-	-	738,664	638,053
Other purchased services	157,123	2,776	74,518	40,651	135,322	4,063	81,225	27,689
Depreciation and amortization	53,349	-	-	-	53,963	-	-	-
Total operating expenses	<u>1,430,091</u>	<u>3,297</u>	<u>683,836</u>	<u>959,862</u>	<u>1,385,213</u>	<u>4,563</u>	<u>857,363</u>	<u>694,457</u>
<b>Operating Income (Loss)</b>	<u>(730,708)</u>	<u>752</u>	<u>32,410</u>	<u>14</u>	<u>(689,051)</u>	<u>(1,891)</u>	<u>(24,829)</u>	<u>(6,132)</u>
<b>Nonoperating Revenues (Expenses)</b>								
Ad valorem tax revenues – net	739,022	-	-	-	717,017	-	-	-
Tobacco settlement revenues	15,248	-	-	-	13,424	-	-	-
Investment income	11,423	15,457	3,035	2,042	7,815	4,901	1,339	308
Interest expense (Note 8)	(11,168)	-	-	-	(11,280)	-	-	-
Contribution to HMOs - net	-	-	-	-	(60,000)	-	45,500	14,500
Other	(97)	(170)	10	-	(453)	(170)	(190)	(16)
Total nonoperating revenues (expenses) – net	<u>754,428</u>	<u>15,287</u>	<u>3,045</u>	<u>2,042</u>	<u>666,523</u>	<u>4,731</u>	<u>46,649</u>	<u>14,792</u>
<b>Capital Contributions</b>	<u>769</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>169</u>	<u>-</u>	<u>-</u>	<u>-</u>
Changes in net position	24,489	16,039	35,455	2,056	(22,359)	2,840	21,820	8,660
<b>Net Position – Beginning of Year, as Previously Reported</b>	507,935	40,230	62,726	52,864	530,294	37,390	85,110	-
<b>Net Position Transfer of Surplus</b>	-	-	(35,000)	35,000	-	-	(44,204)	44,204
<b>Cumulative Effect of Change in Accounting Principle</b>	<u>(131,090)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
<b>Net Position – Beginning of Year, as Restated</b>	<u>376,845</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
<b>Net Position – End of Year</b>	<u>\$ 401,334</u>	<u>\$ 56,269</u>	<u>\$ 63,181</u>	<u>\$ 89,920</u>	<u>\$ 507,935</u>	<u>\$ 40,230</u>	<u>\$ 62,726</u>	<u>\$ 52,864</u>

**Harris County Hospital District,  
d/b/a Harris Health System,  
A Component Unit of Harris County, Texas**  
**Statements of Cash Flows**  
**Years Ended February 28, 2019 and 2018**  
**(In thousands)**

	<b>2019</b>	<b>2018</b>
	<b>Harris Health System</b>	<b>Harris Health System</b>
<b>Operating Activities</b>		
Receipts from and on behalf of patients	\$ 446,285	\$ 401,295
Receipts from Medicaid supplemental programs	168,628	246,593
Receipts from incentive programs and grants	9,850	10,954
Receipts from other revenues	17,688	14,977
Payments to suppliers	(633,629)	(535,102)
Payments to employees and for employee benefits	(736,051)	(713,163)
Net cash used in operating activities	<u>(727,229)</u>	<u>(574,446)</u>
<b>Noncapital Financing Activities</b>		
Contributions – net	526	526
Contribution to HMO	-	(60,000)
Ad valorem taxes – net	738,579	708,145
Tobacco settlement revenues	15,248	13,424
Net cash provided by noncapital financing activities	<u>754,353</u>	<u>662,095</u>
<b>Capital and Related Financing Activities</b>		
Receipt of property taxes for debt service	4,678	4,687
Capital contribution	769	169
Acquisitions and construction of capital assets	(48,197)	(60,518)
Project management - cash on deposit with Harris County	(12,843)	(38,399)
Interest paid	(12,886)	(13,229)
Repayment of long-term debt	(8,179)	(7,849)
Net cash used in capital and related financing activities	<u>(76,658)</u>	<u>(115,139)</u>
<b>Investing Activities</b>		
Receipts of investment income – including realized gains and losses	12,567	7,196
Increase in cash equivalents included in assets limited as to use or restricted	(34,608)	(7,917)
Purchases of investment securities	(582,643)	(577,574)
Proceeds from sale and maturities of investment securities	787,694	727,659
Net cash provided by investing activities	<u>183,010</u>	<u>149,364</u>
<b>Net Increase in Cash and Cash Equivalents</b>	<u>133,476</u>	<u>121,874</u>
<b>Cash and Cash Equivalents - Beginning of Year</b>	<u>210,046</u>	<u>88,172</u>
<b>Cash and Cash Equivalents - End of Year</b>	<u>\$ 343,522</u>	<u>\$ 210,046</u>

**Harris County Hospital District,  
d/b/a Harris Health System,  
A Component Unit of Harris County, Texas  
Statements of Cash Flows (Continued)  
Years Ended February 28, 2019 and 2018  
(In thousands)**

	<b>2019</b>	<b>2018</b>
	<b>Harris Health System</b>	<b>Harris Health System</b>
<b>Reconciliation of Operating Loss to Net Cash Used in Operating Activities</b>		
Operating loss	\$ (730,708)	\$ (689,051)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation and amortization	53,349	53,963
Donation of capital asset	-	(33)
Changes in operating assets and liabilities:		
Decrease (increase) in accounts receivable	(12,402)	5,038
Decrease in inventories	1,948	754
Increase in Medicaid supplemental programs receivable	(13,188)	(20,226)
Decrease (increase) in prepaid expenses and other assets	(16,462)	22,547
Increase in estimated third-party payor settlements	(19,493)	(7,834)
Increase (decrease) in accounts payable and accrued liabilities	(13,766)	16,364
Increase (decrease) in net pension liability	19,958	(1,538)
Decrease in employee compensation and related benefit liabilities	2,492	2,467
Increase (decrease) in compensated absences	(1,504)	1,101
Increase (decrease) in estimated third-party payor settlements	(846)	606
Increase in postemployment health benefit liability	3,393	41,396
	<u>3,479</u>	<u>114,605</u>
Total adjustments	<u>3,479</u>	<u>114,605</u>
Net cash used in operating activities	<u>\$ (727,229)</u>	<u>\$ (574,446)</u>
<b>Supplemental Disclosures of Noncash Operating, Financing and Investing Activities</b>		
Unrealized gain on investments	\$ 252	\$ 842
Amounts related to acquisition of capital assets in accounts payable and accrued liabilities	16,334	12,664
Amount of interest expense capitalized	-	1,371
Impact of GASB 75 adoption	131,090	-

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

**Notes to Financial Statements**

**February 28, 2019 and 2018**

**Note 1: Organization and Mission**

Harris County Hospital District, d/b/a Harris Health System, (the System), a component unit of Harris County, Texas, was created by authorization of the legislature of the State of Texas and subsequent approval by the voters of Harris County, Texas, in November 1965. The System provides patient care to the indigent population of Harris County and receives property taxes levied by Harris County for the provision of this care. The System operates two acute care hospitals and a hospital-based skilled nursing and rehabilitation facility and psychiatric unit, with a total of 645 licensed beds. The System also operates 18 primary care health clinics; 5 specialty clinics providing dental, dialysis, HIV/AIDS treatment and outpatient specialty services; 5 school-based clinics, 5 same day clinics, and 5 mobile health clinics. The System is exempt from federal income taxes.

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

The System's primary mission is to provide quality preventive, medical, hospital and emergency care to the indigent and needy of Harris County and to others with the ability to pay. All activities conducted by the System are directly associated with the furtherance of this mission and are, therefore, considered to be operating activities.

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

Community Health Choice, Inc. and Community Health Choice Texas, Inc. (the HMOs) are Texas not-for-profit corporations organized under Section 501(c)(4) of the Internal Revenue Code to operate as health maintenance organizations. Community Health Choice, Inc. was incorporated on May 8, 1996, licensed by the Texas Department of Insurance on February 14, 1997, and as of December 31, 2018, offered three Medicaid insurance products as well as individual health insurance on the Health Insurance Marketplace. Community Health Choice Texas, Inc. was formed in August 2016 to allow the Health Insurance Marketplace and the Medicaid insurance

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

**Notes to Financial Statements  
February 28, 2019 and 2018**

products to be provided and served by separate corporations. Community Health Choice, Inc. is the Health Insurance Marketplace and commercial HMO with 110,594 and 140,210 enrollees as of December 31, 2018 and 2017, respectively, and Community Health Choice Texas, Inc. is the Medicaid Managed Care HMO with 278,593 and 285,294 enrollees as of December 31, 2018 and 2017, respectively. The HMOs are reported as discretely presented component units of the System since the Board of Directors are appointed by the System's Board of Trustees and the System can impose its will on the HMOs. The differences in amounts due to the System and due from the HMOs in the accompanying statements of net position are primarily due to the presentation of the HMOs financials based on their fiscal year-end of December 31. Financial reports for the HMOs can be obtained from Community Health Choice, Inc., 2636 South Loop West, Ste. 125, Houston, Texas 77054, Attention: Brian P. Maude, Executive Vice President and Chief Financial Officer ([Brian.Maude@CommunityCares.com](mailto:Brian.Maude@CommunityCares.com)).

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

**Note 2: Summary of Significant Accounting Policies**

***Basis of Accounting***

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

***Method of Accounting***

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

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

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

- "Net investment in capital assets" consists of capital assets, net of accumulated depreciation, reduced by the amount outstanding for any bonds, notes, or other financing liabilities that were incurred related to the acquisition, construction or improvement of the capital assets.
- "Restricted" consists of restricted assets reduced by liabilities and deferred inflows of resources related to the assets and are primarily for debt service.

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

**Notes to Financial Statements**

**February 28, 2019 and 2018**

- "Unrestricted" is the net amount of the assets, deferred outflows of resources, liabilities and deferred inflows of resources that are not included in the determination of net investment in capital assets or the restricted component of net position.

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

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

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

***Principles of Reporting***

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

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

The System provides certain administrative services to the HMOs including employment of all individuals who perform the day-to-day requirements of the business functions of the HMOs. The HMOs reimburse the System for such salaries, wages and benefits and these costs are reflected as expenses of the HMOs. An additional fee for indirect costs approximating \$2.2 million and \$1.6 million for fiscal years 2019 and 2018, respectively, is included as a revenue and expense in the System/HMO financial statements. As permitted and limited by the state of Texas laws applicable to insurance companies, the HMOs' Board of Directors have approved certain agreements with the System and unrelated third parties whereby an allocation of surplus capital was committed to fund projects designed to further the HMOs' mission of providing quality health care to the underserved population of southeast Texas. Funds transferred to the System under these agreements are reflected as contributions (distributions) in the statements of revenues, expenses and changes in net position. The System pays a portion of the premiums for enrollees to Community Health Choice, Inc. for insurance coverage under the insurance plans that are offered as part of the HMO's mission. Premiums paid on behalf of enrollees were \$13.4 million and \$4.6 million for fiscal years 2019 and 2018, respectively, which is included as expense and revenue in the System/Community Health Choice, Inc. financial statements.

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

**Notes to Financial Statements  
February 28, 2019 and 2018**

The System supports the Foundation with payments for goods and services of approximately \$565,000 and \$569,000 in fiscal years 2019 and 2018, 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 \$1,097,000 and \$1,584,000 in 2019 and 2018, respectively. In addition, the Foundation distributed to the System contributions totaling \$1,269,000 and \$500,000 in 2019 and 2018, respectively, from its multi-year Capital Campaign funds.

***Cash, Cash Equivalents and Short-term Investments***

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

The System's and HMOs' cash, cash equivalents and short-term investments are invested in fully collateralized time deposits, certificates of deposit and government securities as authorized by Chapter 281 of the *Texas Health and Safety Codes* and Chapter 116 of the *Texas Local Government Code*, except as disclosed in Note 6. Such total collateralization and insurance coverage is required by the Board of Trustees of the System. The Foundation's investments, however, are not subject to these laws.

Investments are reported at fair value, with realized and unrealized gains and losses included in investment income in the statements of revenues, expenses and changes in net position.

***Foundation Net Position***

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

***Inventories***

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

***Capital Assets***

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

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

**Notes to Financial Statements**

**February 28, 2019 and 2018**

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

***Compensated Absences***

The System maintains a paid time-off plan. Under the paid time-off plan, the cost of all compensated absences is accrued at the time the benefits are earned. At the option of the employee, unused benefits may be liquidated at 50 percent or at the time of termination, unused benefits are payable at 75 percent. Changes in the System's liability for compensated absences in fiscal years 2019 and 2018 are as follows (in thousands).

<u>Fiscal</u>	<u>Beginning of Year Liability</u>	<u>Current Year Claims and Change in Estimates</u>	<u>Claim Payments</u>	<u>End of Year Liability</u>
2019	\$ 36,753	\$ 65,316	\$ 66,820	\$ 35,249
2018	35,652	69,984	68,883	36,753

***Classification of Revenues and Expenses***

Operating revenues include those generated from direct patient care and related support services. Nonoperating revenues consist of those revenues that are related to financing and investing types of activities and result from nonexchange transactions or investment income. Operating expenses include those related to direct patient care and related support services. Nonoperating expenses include interest expense and other expenses that are not considered operating.

***Net Patient Service Revenue and Accounts Receivable***

Net patient service revenue is reported as the estimated net realized amounts from patients, third-party payors, and others for services rendered and includes estimated retroactive revenue adjustments under reimbursement agreements with third-party payors. In recognizing net patient service revenue, estimates are used in recording allowances for contractual adjustments and noncollectible accounts. Allowances for noncollectible accounts are estimated using historical experience, current trend information, aged account balances and a collectability analysis. The System's financial assistance program for uninsured patients classified as self-pay determines expected payments based on the Medicare allowable reimbursement. Charges in excess of the expected payment are reflected as an administrative uninsured discount. The allowance for uncollectible accounts was estimated at \$65.1 million and \$85.1 million as of February 28, 2019 and 2018, respectively. The System provides services under contract to patients covered under the

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

**Notes to Financial Statements  
February 28, 2019 and 2018**

Medicare and Medicaid programs. Net revenues from these programs are included in patient service revenue at estimated reimbursement based on customary billing charges, predetermined rates of reimbursement, plus certain adjustments. The amounts due to or from these programs are subject to final review and settlement by the program fiscal intermediary. Retroactive adjustments under third-party reimbursement agreements are considered in the recognition of revenue on an estimated basis in the period the related services are rendered, and such amounts are adjusted in future periods as adjustments become known. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, it is reasonably possible that these estimates could differ from actual settlements and thus change in the near term by material amounts. The System recognized an increase in net patient service revenue of \$0.7 million during 2019 and \$0.2 million during 2018, respectively, from the differences between estimated and actual cost report settlements and appeals.

***Charity Care Policy***

The System accepts all Harris County residents as patients regardless of their ability to pay. Harris County residents may qualify for partial financial assistance, on a sliding scale. The extent to which a resident will be financially responsible is determined based upon pre-established financial criteria, which utilize family income and size as it relates to the federal poverty guidelines set by the U.S. Department of Health and Human Services. Charity services are defined as those services for which no payment is anticipated. These amounts are not reported as revenue. The System maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges foregone for services and supplies furnished under the System's Financial Assistance program. The following information measures the level of charity care provided during the years ended February 28, 2019 and 2018 (in thousands):

	<b>2019</b>	<b>2018</b>
Charges forgone, based on established rates	\$ 1,239,968	\$ 1,402,321
Cost of foregone charges, estimated	650,040	651,623

***Premium Revenue***

Premium revenue is recognized as revenue by the HMOs during the coverage period of the subscriber agreement. For the primary Medicaid business, notification is received throughout the year of any new, removed or revised members and the date of eligibility for coverage. The date of notification may be subsequent to the date of eligibility. The HMOs believe premium revenue has been appropriately recognized for the years ended December 31, 2018 and 2017.

***Medical Claims Expense***

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

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

**Notes to Financial Statements  
February 28, 2019 and 2018**

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, 2018 and 2017, the HMOs recognized no premium deficiency reserve for the Health Insurance Marketplace business.

Changes in the HMOs' aggregate liability for medical claims in fiscal years 2019 and 2018 are as follows (in thousands):

<b>Fiscal Year</b>	<b>Beginning of Fiscal Liability</b>	<b>Medical Claims and Change in Estimates</b>	<b>Claim Payments</b>	<b>End of Fiscal Year Liability</b>
2019	\$ 158,903	\$ 1,498,768	\$ 1,507,722	\$ 149,949
2018	111,728	1,287,335	1,240,160	158,903

In fiscal year 2019, the HMOs in aggregate paid \$1,421.8 million in claims related to the current fiscal year and \$85.9 million in claims related to the prior fiscal year. In fiscal year 2018, the HMOs paid \$1,122.2 million in claims related to the current fiscal year and \$117.9 million in claims related to the prior fiscal year.

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

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

**Notes to Financial Statements**

**February 28, 2019 and 2018**

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

The HMOs participate in the federally facilitated health insurance exchange in 10 southeast Texas counties. The exchange was created pursuant to the ACA under regulations established by the U.S. Department of Health and Human Services (HHS). Under these rules, HHS pays the HMO a portion of the policy premium, in the form of Advanced Premium Tax Credit (APTC), and part of the health care costs, in the form of Cost Sharing Reduction (CSR), for low income individual exchange members. HHS also administers certain risk management programs as detailed below.

The HMOs recognize premiums received from its exchange members and APTC received from HHS as premium revenue when earned and CSR offsets health care costs when incurred. For 2019, the HMOs recognized \$494.0 million and \$0 of APTC and CSR, respectively. For 2018, the HMOs recognized \$418.6 million and \$68.9 million of APTC and CSR, respectively.

The ACA established a permanent risk adjustment program which adjusts the premiums that commercial, individual and small group health insurance issuers receive based on the demographic factors and health status of each member as derived from current year medical diagnosis as reported throughout the year. This program transfers funds from lower risk plans to higher risk plans with similar plans in the same state. The risk adjustment program is applicable to commercial, individual and small group health plans (except certain exempt and grandfathered plans) operating both inside and outside of the exchange. A risk score is determined for the entire subject population for each market in each state. Plans with an average risk score below the state average will pay into a pool and health insurance issuers with an average risk score that is greater than the state average risk score will receive money from that pool. The HMOs issues individual plans and is therefore subject to the risk adjustment. At December 31, 2018 and 2017 the HMOs recorded a risk adjustment payable of \$13.7 million and \$51.7 million, respectively.

***Ad Valorem Tax Revenues – Net***

Ad valorem tax revenues are recorded in the year for which the taxes are levied, net of provisions for uncollectible amounts, collection expenses and appraisal fees. Harris County Commissioners' Court levies a tax for the System as provided under state law. The taxes are collected by the Harris County Tax Assessor – Collector and are remitted to the System as received. On January 1, at the time of assessment, an enforceable lien is attached to the property for property taxes. Taxes are levied and become collectible from October 1 to January 31 of the succeeding year. Subsequent adjustments to the tax rolls, made by the County Assessor, are included in revenues in the period such adjustments are made by the County Assessor. Harris County also enters into property tax abatement agreements with local businesses under the state Property Redevelopment and *Tax Abatement Act*, Chapter 312, as well as its own guidelines and criteria, which is required under the Act.

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

**Notes to Financial Statements**

**February 28, 2019 and 2018**

***Tobacco Settlement Revenues***

In the fiscal years ended February 28, 2019 and 2018, 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 health care costs. Under the program guidelines, the System is free to use the funds in either the immediate or future periods without restriction. The System recognizes all funds received from the settlement as nonoperating revenue in the period funds are allocated.

***Pensions***

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

***Postemployment Benefits Other Than Pensions***

The System has a single-employer defined benefit other postemployment benefit (OPEB) plan. For purposes of measuring the net OPEB liability, deferred outflows and deferred inflows of resources related to OPEB, and OPEB expense have been determined on the same basis as they are reported by the OPEB plan. For this purpose, the System recognizes benefit payments when due and payable in accordance with the benefit terms.

***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.

***Change in Accounting Principle***

GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions* (OPEB), was implemented during fiscal year 2019. The revised requirements establish new financial reporting requirements for state and local governments which provide their employees with OPEB benefits, including additional note disclosures and required supplementary information. In addition, GASB Statement No. 75 requires a state or local government employer to use the entry age normal actuarial cost method, and requires deferred outflows of resources and deferred inflows of resources which arise from other types of events related to OPEB to be recognized. Restatement of the 2018 financial statements is not practical because prior year information calculated under the provisions of GASB Statement No. 75 is not available.

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

**Notes to Financial Statements  
February 28, 2019 and 2018**

Accordingly, the System has reported the cumulative effect of applying GASB Statement No. 75 as a restatement of net position as of March 1, 2018. This restatement decreased previously reported net position by \$131,090.

***Newly Adopted Accounting Pronouncements***

GASB Statement No. 85, *Omnibus 2017*. The Statement addresses a variety of issues identified during implementation and application of certain GASB Statements related to blending component units, goodwill, fair value measurement and application, and pensions and other postemployment benefits.

GASB Statement No. 89, *Accounting for Interest Cost Incurred before the End of a Construction Period*. This statement removes the concept of capitalized interest from all types of governmental entities. The System has elected to early adopt this standard and does not require restatement of the 2018 financial statements and should be applied prospectively.

***Pending Adoption of Recent Accounting Pronouncements***

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

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

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

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

**Notes to Financial Statements  
February 28, 2019 and 2018**

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

GASB Statement No. 90 – *Majority Equity Interests*, an amendment of GASB Statements No. 14 and No. 61, defines an equity interest in a legally separate organization and establishes how majority equity interests should be reported in the financial statements. A majority equity interest that meets the definition of an investment under GASB Statement No. 72, *Fair Value Measurement and Application*, should be reported as an investment and measured using the equity method, unless it is held by a special-purpose government engaged only in fiduciary activities, a fiduciary fund or an endowment (including permanent and term endowments) or permanent fund. Those governments and funds should measure the majority equity interest at fair value. The requirements of this statement are effective for reporting periods beginning after December 15, 2018. Earlier application is encouraged.

**Note 3: Net Patient Service Revenue**

The System has agreements with third-party payors that provide for payments to the System at amounts different from its established rates. The amounts by which the established billing rates exceed the amounts recoverable from these programs are written off and accounted for as contractual allowances. A summary of the payment arrangements with major third-party payors follows:

*Medicare* – Inpatient acute care services and defined capital costs related to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical diagnostic and other factors. Medicare outpatient services are reimbursed on fee schedules and on a prospective basis through ambulatory payment classifications, which are based on clinical resources used in performing the procedures. The System's Medicare cost reports have been audited by the Medicare administrative contractor through February 29, 2012.

*Medicaid* – Inpatient services rendered to Medicaid program beneficiaries are paid at prospectively determined rates per discharge similar to those of the Medicare inpatient program. Medicaid outpatient services are paid by fee schedules for specific services, including outpatient surgery, imaging and laboratory services. Other outpatient services are reimbursed on reasonable cost, based on a percentage from the System's most recent Medicaid cost report tentative settlement as of March 1, 2013. The System's Medicaid cost reports have been settled by the Medicaid administrative contractor through February 29, 2012.

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

**Notes to Financial Statements  
February 28, 2019 and 2018**

Cash received from the Medicare program accounted for approximately 42 percent and 37 percent of the System's total cash collections for net patient service revenue for years ended February 28, 2019 and 2018, respectively. Cash received from the Medicaid program (including managed Medicaid) accounted for approximately 36 percent and 39 percent of the System's total cash collections for net patient service revenue for the years ended February 28, 2019 and 2018, respectively.

Compliance with laws and regulations governing the Medicare and Medicaid programs can be subject to future government review and interpretation, as well as significant regulatory action, including fines, penalties and exclusion from the Medicare and Medicaid programs.

**Note 4: Medicaid Supplemental Programs**

The Disproportionate Share III (DSH) program was created in fiscal 1992 by the state of Texas to access additional federal matching funds. These funds are distributed to selected hospitals that provide services to low-income and uninsured patients.

The Upper Payment Limit (UPL) program was created in May 2002 with an effective date of July 2001. The UPL program used federal matching funds to raise state Medicaid reimbursement rates to 100 percent of equivalent Medicare rates for certain public hospital systems. In December 2011, Texas received federal approval to redirect the funding it would have received under the UPL program over the next five years into a new reform plan (1115 Waiver). The 1115 Waiver has been renewed through September 2022. The 1115 Waiver allows the state to expand Medicaid managed care, improve Medicaid services and reward performance. Federal funding that would have been received by hospitals if managed care was not expanded is to be preserved. The UPL program was replaced with two new pools of funding, the uncompensated care (UC) pool and the delivery system reform incentive payment (DSRIP) pool. The UC pool directs more funding to hospitals that serve large numbers of uninsured patients and the DSRIP pool provides incentive payments for health care providers based on improvements in quality of care. As of February 28, 2019, the System also participates in three other Medical Supplemental Payment Programs, the Network Access Improvement Program (NAIP), the Uniform Hospital Rate Increase Program (UHRIP) and the new Graduate Medical Education (GME) program.

The System recognizes all funds received under the DSH, UC, DSRIP, NAIP, GME and UHRIP programs as operating revenues in the period applicable to the funds. Any amounts related to that year that are not received as of fiscal year-end are recorded as receivables and reflected in other current assets in the accompanying statements of net position. These receivables can be subject to adjustments that are reflected in the period they become known. The System recorded an unfavorable adjustment of \$10.8 million and a favorable adjustment of \$1.8 million in fiscal year 2019 and 2018, respectively, for prior years' programs. The System's financial statements reflect current liabilities of \$1.7 million and \$14.4 million at February 28, 2019 and 2018, respectively, and receivables of \$35.3 million and \$22.1 million at February 28, 2019 and 2018, respectively, related to the Medicaid Supplemental Programs. The rate increase for the System associated with UHRIP for the period March 1, 2018 through August 31, 2018, was 49 percent. The rate increase for the System for the period from September 1, 2018 through February 28, 2019 was 46 percent.

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

**Notes to Financial Statements  
February 28, 2019 and 2018**

**Note 5: Assets Limited as to Use or Restricted**

Assets limited as to use or restricted represent those assets whose use has been legally restricted related to the 2010 and 2016 refunding and revenue bond issues (50 percent of the greatest debt service requirement scheduled to occur); unspent bond proceeds; funds restricted by donors; or funds designated by the board for other uses. Investments in U.S. Treasury, agency and instrumentality obligations with a remaining maturity of one year or less at the time of acquisition and in nonnegotiable certificates of deposit are carried at amortized cost. All other investments are recorded at fair value. The fair values of securities are based on appropriate valuation methodologies by third parties, quoted market prices and information available to management as of February 28, 2019 and 2018. The components of assets limited as to use or restricted at fair value at February 28, 2019 and 2018, are as follows (in thousands):

Description of Assets	2019				
	Total	Restricted Debt Service	BT Level 1 Trauma	Cash on with Harris County Project Management	Other
Money market government funds	\$ 50,292	\$ 30,644	\$ 19,382	\$ -	\$ 266
Commercial paper	11,590	1,049	9,967	-	574
Other	39,887	-	-	39,887	-
	101,769	31,693	29,349	39,887	840
Less funds required for current liabilities	(6,595)	(6,595)	-	-	-
	<u>\$ 95,174</u>	<u>\$ 25,098</u>	<u>\$ 29,349</u>	<u>\$ 39,887</u>	<u>\$ 840</u>
Description of Assets	2018				
	Total	Restricted Debt Service	BT Level 1 Trauma	Cash on with Harris County Project Management	Other
Money market government funds	\$ 15,684	\$ 143	\$ 15,295	\$ -	\$ 246
Commercial paper	48,113	19,773	27,773	-	567
Government securities	21,300	11,187	10,113	-	-
Other	59,479	-	-	59,479	-
	144,576	31,103	53,181	59,479	813
Less funds required for current liabilities	(6,352)	(6,352)	-	-	-
	<u>\$ 138,224</u>	<u>\$ 24,751</u>	<u>\$ 53,181</u>	<u>\$ 59,479</u>	<u>\$ 813</u>

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

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

**Notes to Financial Statements  
February 28, 2019 and 2018**

Foundation – Assets limited as to use of \$44.7 million and \$29.2 million at February 28, 2019 and 2018, respectively, are restricted subject to donor-imposed stipulations that will be met by actions of the Foundation or the passage of time.

**Note 6: Investment Risk**

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

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

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

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

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

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

**Notes to Financial Statements  
February 28, 2019 and 2018**

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

The table below indicates the fair value and maturity amount of the System's cash equivalents, assets limited as to use and investments as of February 28, 2019 and 2018, 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).

<b>2019</b>					
<b>Security</b>	<b>Fair Value</b>	<b>Percentage of Portfolio</b>	<b>Maturity Amount</b>	<b>Modified Duration (Years)</b>	<b>Credit Rating S&amp;P/Rating Moody's</b>
Commercial paper:					
Toyota Motor Credit Corp (TMCC)	\$ 309,672	38.57 %	\$ 313,533	0.455	A-1+
Exxon Mobile Corp	74,730	9.31	75,000	0.144	A-1+
Mitsubishi UFJ Financial Group	198,841	24.77	200,000	0.227	A-1
Money market mutual funds	<u>219,627</u>	<u>27.35</u>	<u>219,627</u>	<u>0.003</u>	AAA/Aaa
Total cash equivalents, assets limited as to use and investments	<u>\$ 802,870</u>	<u>100.00 %</u>	<u>\$ 808,160</u>	<u>0.247</u>	
<b>2018</b>					
<b>Security</b>	<b>Fair Value</b>	<b>Percentage of Portfolio</b>	<b>Maturity Amount</b>	<b>Modified Duration (Years)</b>	<b>Credit Rating S&amp;P/Rating Moody's</b>
Commercial paper:					
Toyota Motor Credit Corp (TMCC)	\$ 424,997	50.57 %	\$ 428,036	0.357	A-1+
Exxon Mobile Corp	19,939	2.37	20,000	0.178	A-1+
GE Capital Corporation	168,347	20.03	170,578	0.613	A-1-
U.S. agency notes:					
FHLMC note	9,960	1.19	10,000	0.496	AAA/Aaa
U.S. Treasury Note	60,986	7.26	61,182	0.375	AAA/Aaa
Money market mutual funds	<u>156,198</u>	<u>18.58</u>	<u>156,198</u>	<u>0.003</u>	AAA/Aaa
Total cash equivalents, assets limited as to use and investments	<u>\$ 840,427</u>	<u>100.00 %</u>	<u>\$ 845,994</u>	<u>0.342</u>	

*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.

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

**Notes to Financial Statements  
February 28, 2019 and 2018**

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, 2019 and 2018, the balance per the bank of Community Health Choice, Inc. demand and time deposits was \$6.0 million and \$6.2 million, respectively, of which \$5.7 million and \$6.0 million, respectively, was uninsured and uncollateralized.

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

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

According to the System's investment policy, no more than 50 percent of the portfolio, excluding those investments held for future capital expenditures, debt service payments, bond fund reserve accounts, and capitalized interest funds, may be invested beyond 36 months. Additionally, at least 15 percent of the portfolio, with the previous exceptions, is invested in overnight instruments or in marketable securities that can be sold to raise cash within one day's notice. Overall, the average maturity of the portfolio, with the previous exceptions, shall not exceed three years. As of February 28, 2019 and 2018, the System was in compliance with these guidelines.

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

The table below indicates the fair value and maturity amount of the cash equivalents, assets limited as to use and investments of Community Health Choice, Inc. as of December 31, 2018 and 2017 summarized by security type. Also demonstrated are the percentage of total portfolio and the modified duration in years for each summarized security type (in thousands).

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

**Notes to Financial Statements  
February 28, 2019 and 2018**

2018					
Security	Fair Value	Percentage of Portfolio	Maturity Amount	Modified Duration (Years)	Credit Rating S&P/Rating Moody's
Municipal bonds	\$ 31,920	23.00 %	\$ 31,765	0.317	AAA/AA+/AA
Certificates of deposit	3,325	2.39	3,325	0.429	AAA
Money market mutual funds	103,549	74.61	103,549	0.045	AAA
	<u>\$ 138,794</u>	<u>100.00 %</u>	<u>\$ 138,639</u>	<u>0.065</u>	
2017					
Security	Fair Value	Percentage of Portfolio	Maturity Amount	Modified Duration (Years)	Credit Rating S&P/Rating Moody's
Municipal bonds	\$ 8,059	3.71 %	\$ 8,085	0.455	AAA/Aaa
Certificates of deposit	3,325	1.53	3,325	0.479	AAA
Money market mutual funds	205,955	94.76	205,955	0.003	AAA
	<u>\$ 217,339</u>	<u>100.00 %</u>	<u>\$ 217,365</u>	<u>0.312</u>	

The table below indicates the fair value and maturity amount of the cash equivalents, assets limited as to use and investments of Community Health Choice Texas, Inc. as of December 31, 2018 and 2017, summarized by security type. Also demonstrated are the percentage of total portfolio and the modified duration in years for each summarized security type (in thousands).

2018					
Security	Fair Value	Percentage of Portfolio	Maturity Amount	Modified Duration (Years)	Credit Rating S&P/Rating Moody's
Municipal bonds	\$ 30,448	18.83 %	\$ 30,455	0.523	AAA/AA+/AA
Certificates of deposit	600	0.37	600	0.185	AAA
Money market mutual funds	130,642	80.80	130,642	0.003	AAA
	<u>\$ 161,690</u>	<u>100.00 %</u>	<u>\$ 161,697</u>	<u>0.379</u>	
2017					
Security	Fair Value	Percentage of Portfolio	Maturity Amount	Modified Duration (Years)	Credit Rating S&P/Rating Moody's
Municipal bonds	\$ 30,473	35.72 %	\$ 30,728	0.998	AAA/Aaa
Certificates of deposit	600	0.70	600	0.185	AAA
Money market mutual funds	54,248	63.58	54,248	0.003	AAA
	<u>\$ 85,321</u>	<u>100.00 %</u>	<u>\$ 85,576</u>	<u>0.345</u>	

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

**Notes to Financial Statements  
February 28, 2019 and 2018**

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

The following is a summary of the hierarchy of the fair value of cash equivalents, assets limited as to use, investments, and derivative instrument (Note 8) of the System as of February 28, 2019 and 2018 (in thousands).

	<b>2019 Fair Value Measurements Using</b>			
	<b>Quoted Prices in Active Markets for Identical Assets (Level 1)</b>	<b>Significant Other Observable Inputs (Level 2)</b>	<b>Significant Unobservable Inputs (Level 3)</b>	<b>Total</b>
Commercial paper	\$ -	\$ 583,243	\$ -	\$ 583,243
Money market mutual funds	219,627	-	-	219,627
Total cash equivalents, assets limited as to use and investments by fair value	<u>\$ 219,627</u>	<u>\$ 583,243</u>	<u>\$ 0</u>	<u>\$ 802,870</u>
Derivative financial instrument	<u>\$ 0</u>	<u>\$ 7,918</u>	<u>\$ 0</u>	<u>\$ 7,918</u>
	<b>2018 Fair Value Measurements Using</b>			
	<b>Quoted Prices in Active Markets for Identical Assets (Level 1)</b>	<b>Significant Other Observable Inputs (Level 2)</b>	<b>Significant Unobservable Inputs (Level 3)</b>	<b>Total</b>
Commercial paper	\$ -	\$ 613,283	\$ -	\$ 613,283
U.S. agency and Treasury notes	-	70,946	-	70,946
Money market mutual funds	156,198	-	-	156,198
Total cash equivalents, assets limited as to use and investments by fair value	<u>\$ 156,198</u>	<u>\$ 684,229</u>	<u>\$ 0</u>	<u>\$ 840,427</u>
Derivative financial instrument	<u>\$ 0</u>	<u>\$ 6,437</u>	<u>\$ 0</u>	<u>\$ 6,437</u>

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

**Notes to Financial Statements  
February 28, 2019 and 2018**

The following is a summary of the hierarchy of the fair value of investments and cash equivalents of Community Health Choice, Inc. as of December 31, 2018 and 2017 (in thousands):

	<b>2018 Fair Value Measurements Using</b>			<b>Total</b>
	<b>Quoted Prices in Active Markets for Identical Assets (Level 1)</b>	<b>Significant Other Observable Inputs (Level 2)</b>	<b>Significant Unobservable Inputs (Level 3)</b>	
Municipal bonds	\$ -	\$ 31,920	\$ -	\$ 31,920
Money market mutual funds	103,549	-	-	103,549
Total investments and cash equivalents by fair value level	<u>\$ 103,549</u>	<u>\$ 31,920</u>	<u>\$ 0</u>	<u>\$ 135,469</u>

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

The following is a summary of the hierarchy of the fair value of investments and cash equivalents of Community Health Choice Texas, Inc. as of December 31, 2018 and 2017 (in thousands):

	<b>2018 Fair Value Measurements Using</b>			<b>Total</b>
	<b>Quoted Prices in Active Markets for Identical Assets (Level 1)</b>	<b>Significant Other Observable Inputs (Level 2)</b>	<b>Significant Unobservable Inputs (Level 3)</b>	
Municipal bonds	\$ -	\$ 30,448	\$ -	\$ 30,448
Money market mutual funds	130,642	-	-	130,642
Total investments and cash equivalents by fair value level	<u>\$ 130,642</u>	<u>\$ 30,448</u>	<u>\$ 0</u>	<u>\$ 161,090</u>

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

**Notes to Financial Statements  
February 28, 2019 and 2018**

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

**Note 7: Capital Assets**

The System's investment in capital assets as of February 28, 2019 and 2018, consists of the following (in thousands):

	2019			Ending Balance
	Beginning Balance	Additions/ Transfers	Retirements	
Land and improvements	\$ 43,096	\$ 2,347	\$ (8)	\$ 45,435
Buildings and fixed equipment	641,490	20,789	(2,639)	659,640
Major movable equipment	365,114	32,919	(10,394)	387,639
Total historical cost	1,049,700	56,055	(13,041)	1,092,714
Less accumulated depreciation:				
Land and improvements	(12,426)	(877)	7	(13,296)
Buildings and fixed equipment	(355,463)	(25,150)	2,327	(378,286)
Major moveable equipment	(279,304)	(27,322)	9,722	(296,904)
Total accumulated depreciation	(647,193)	(53,349)	12,056	(688,486)
Construction in progress	33,459	28,609	-	62,068
Capital assets - net	\$ 435,966	\$ 31,315	\$ (985)	\$ 466,296

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

**Notes to Financial Statements  
February 28, 2019 and 2018**

	2018			Ending Balance
	Beginning Balance	Additions/ Transfers	Retirements	
Land and improvements	\$ 42,012	\$ 1,084	\$ -	\$ 43,096
Buildings and fixed equipment	616,643	27,686	(2,839)	641,490
Major movable equipment	351,041	34,038	(19,965)	365,114
Total historical cost	<u>1,009,696</u>	<u>62,808</u>	<u>(22,804)</u>	<u>1,049,700</u>
Less accumulated depreciation:				
Land and improvements	(11,374)	(1,052)	-	(12,426)
Buildings and fixed equipment	(332,905)	(24,698)	2,140	(355,463)
Major moveable equipment	(269,720)	(28,213)	18,629	(279,304)
Total accumulated depreciation	<u>(613,999)</u>	<u>(53,963)</u>	<u>20,769</u>	<u>(647,193)</u>
Construction in progress	26,312	7,147	-	33,459
Capital assets - net	<u>\$ 422,009</u>	<u>\$ 15,992</u>	<u>\$ (2,035)</u>	<u>\$ 435,966</u>

Depreciation expense for the years ended February 28, 2019 and 2018, was \$53.3 million and \$54.0 million, respectively.

**Note 8: Long-Term Debt**

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

**Revenue Bonds**

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

In October 2016, the System refunded and refinanced the Series 2007A Bonds by issuing the \$160,220,000 Series 2016 Senior Lien Refunding Revenue bonds at a premium of \$15,425,353.

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

**Notes to Financial Statements  
February 28, 2019 and 2018**

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

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

In August 2010, the System refunded and refinanced the Series 2007B Bonds by issuing Series 2010 Refunding and Revenue bonds in the amount of \$104,435,000. The proceeds of the Series 2010 Bonds covered costs of issuance and defeased the Harris County Hospital District Senior Lien Refunding Revenue Bonds, Series 2007B, in the principal amount of \$103,525,000 through the irrevocable deposit of sufficient funds with trustees to pay the principal and interest of such bonds through maturity. Accordingly, these trustee funds and the related defeased indebtedness are excluded from the balance sheet. The refunding resulted in a loss of \$21.5 million, which includes \$16.2 million deferred loss on refunding related to the interest rate swap, which has been deferred and is being amortized over the life of the Series 2007B Bond issue. The remaining loss on refunding of \$5.3 million has been deferred and is being amortized to interest expense over the life of the Series 2000 bond issue. The primary components of this loss were the write-offs of unamortized deferred financing costs and bond premiums, the net deferred amount related to the hedging derivative instrument associated with the 2007B Bonds and the difference between amounts funded for the defeasance and the principal due on the 2007B Bonds. The financial statements reflect deferred outflows-unamortized debt refunding loss of \$9.6 million and \$10.3 million at February 28, 2019 and 2018, respectively. Principal amounts of total defeased indebtedness outstanding at February 28, 2019 and 2018, are \$79.8 million and \$85.9 million, respectively. The bonds are secured by an irrevocable letter of credit issued by JPMorgan Chase Bank.

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

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

**Notes to Financial Statements  
February 28, 2019 and 2018**

Under an irrevocable letter of credit issued by JPMorgan Chase Bank, only the tender agent is entitled to draw an amount sufficient to pay the principal amount of the bonds when due, or to pay the portion of the purchase price corresponding to the principal amount upon certain tenders. The letter of credit facility's expiration date of August 12, 2017, has been amended and extended to August 12, 2021. Unreimbursed advances will accrue interest at the higher of (i) the Prime Rate, (ii) one-month LIBOR plus 2.5 percent, or (iii) 7.5 percent per annum. The System is also required to pay to the JPMorgan Chase Bank an annual facility fee for the letter of credit of 0.80 percent per annum of the outstanding principal amount of the bonds. No amounts were outstanding on the letter of credit as of February 28, 2019 and 2018. 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, 2019 and 2018.

**Interest Rate Swap**

*Related Bonds* – On September 25, 2007, the System entered into an interest rate swap agreement in connection with its \$103,525,000 Harris County Hospital District Senior Lien Revenue and Refunding Bonds, Series 2007B with the settlement date on October 3, 2007. On August 12, 2010, when the System refunded and refinanced the Series 2007B Bonds by issuing Series 2010 Bonds, the interest rate swap was redesignated and associated with the new debt. The derivative contained an off market element equal to the value of the swap associated with the Series 2007B Bonds on August 12, 2010. In accordance with GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, this off-market element is recorded as a borrowing payable and is amortized as an adjustment to interest expense over the life of the swap agreement.

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

Swap terms:

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

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

**Notes to Financial Statements**

**February 28, 2019 and 2018**

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

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

*Fair Value* – The redesignated swap that is associated with the new debt had a zero fair value at its inception date and a fair value of \$(7.9) million and \$(6.4) million at February 28, 2019 and 2018, respectively, and is reported as a derivative liability in the statements of net position. The fair value of the swap was determined by calculating the present value of the anticipated future cash flows for both the floating portion and the stated fixed rate portion using discount factors derived from the London Interbank Offered Rate (LIBOR) swap curve.

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

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

*Collateral Posting Risk* – The risk that the System will be required to secure its obligations under the swap agreement. Any securities posted as collateral would not be available for the System's expenditure or reserve needs, which could adversely impact credit ratings and overall liquidity and budgetary efforts. The System was not exposed to collateral posting risk as of and for the years ended February 28, 2019 and 2018.

*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, 2019, the swap counterparty was rated AA- by Standard & Poor's, Baa2 by Moody's Investor Services, and BBB+ by Fitch. As of February 28, 2018, the swap counterparty was rated A- by Standard & Poor's and Baa2 by Moody's Investor Services and BBB+ by Fitch. At February 28, 2019, the System was rated AA- by Standard & Poor's, A2 by Moody's Investor Services and AA by Fitch. At February 28, 2018, the System was rated A by Standard & Poor's, A2 by Moody's Investor Services and AA by Fitch.

*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, 2019 and 2018, the System was not exposed to rollover risk.

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

**Notes to Financial Statements  
February 28, 2019 and 2018**

*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, 2019 and 2018, termination of the original swap agreement would create a liability of \$19.1 million and \$17.8 million, respectively, and would result in a reversal of the derivative liability related to the redesignated swap, the borrowing payable amount and the unamortized loss on refunding. Any resulting net change would be recorded through nonoperating expenses.

*Swap Payments* – Using interest rates as of February 28, 2019, 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.

2019				
Years Ending February	Debt Principal	Debt Interest	Swaps, Net	Total
2020	\$ 6,175	\$ 10,086	\$ (1,111)	\$ 15,150
2021	6,470	9,796	(1,077)	15,189
2022	6,765	9,491	(1,049)	15,207
2023	7,080	9,173	(1,017)	15,236
2024	7,400	8,840	(983)	15,257
2025-2029	42,600	38,625	(4,355)	76,870
2030-2034	53,090	28,049	(3,279)	77,860
2035-2039	64,220	16,768	(1,963)	79,025
2040-2042	44,965	3,638	(423)	48,180
Total	\$ 238,765	\$ 134,466	\$ (15,257)	\$ 357,974

*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, 2019 and 2018, was as follows (in thousands).

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

**Notes to Financial Statements  
February 28, 2019 and 2018**

	2019	2018
Beginning balance	\$ 11,139	\$ 11,932
Reductions	(773)	(793)
Ending balance	\$ 10,366	\$ 11,139

The following table sets forth as of February 28, 2019, the amortization of the hybrid instrument borrowings for the next five years and thereafter (in thousands).

Years ending February:	
2020	\$ 754
2021	733
2022	712
2023	690
2024	667
2025-2029	2,960
2030-2034	2,227
2035-2039	1,334
2040-2042	289
Total	\$ 10,366

***Certificates of Obligation***

In August 2016, the System issued Combination Tax and Revenue Certificates of Obligation, Series 2016 in the principal amount of \$62,815,000. The funds are to be used to expand the operative suites and supporting services at Ben Taub Hospital necessary to maintain the facility's Level 1 Trauma status. The bonds mature in February 2036. The System's financial statements reflect \$57.3 million and \$59.5 million in outstanding principal and \$6.3 million and \$6.9 million in unamortized premium related to this debt at February 28, 2019 and 2018, respectively. Principal and interest paid was \$4.7 million and \$4.7 million, and tax revenue applicable to debt service was \$4.7 million and \$4.7 million for 2019 and 2018, respectively. Annual debt service requirements to maturity as of February 28, 2019 are as follows (in thousands).

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

**Notes to Financial Statements  
February 28, 2019 and 2018**

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Years ending February:			
2020	\$ 2,295	\$ 2,394	\$ 4,689
2021	2,410	2,280	4,690
2022	2,530	2,159	4,689
2023	2,660	2,033	4,693
2024	2,790	1,899	4,689
2025-2029	15,975	7,482	23,457
2030-2034	19,795	3,663	23,458
2035-2036	8,845	534	9,379
	<hr/>	<hr/>	<hr/>
Total	\$ 57,300	\$ 22,444	\$ 79,744
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>

**Other Obligations**

Other long-term obligations at February 28, 2019, are as follows (in thousands):

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Years ending February:			
2020	\$ 76	\$ 4	\$ 80
2021	50	3	53
2022	38	1	39
2023	10	-	10
	<hr/>	<hr/>	<hr/>
Total	\$ 174	\$ 8	\$ 182
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>

**Note 9: Employee Benefit Plans**

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

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

**Notes to Financial Statements  
February 28, 2019 and 2018**

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

***Defined Contribution Plan***

The System has a defined contribution 401(k) plan (which qualifies as a tax-exempt employee benefit plan under Section 401(a) of the Internal Revenue Code) (401(k) Plan) open to all full-time and part-time employees of the System who meet the plan's requirements. It is a single-employer, self-administered, trustee plan to which contributions are made by participants on a biweekly basis not to exceed the statutory maximum of \$18,500 and \$18,000 during calendar years 2018 and 2017, respectively, for all participants. Contributions to the plan cannot exceed the statutory maximum of \$24,500 and \$24,000 during calendar years 2018 and 2017, respectively, for participants age 50 and older. Effective July 2007, the System enhanced the 401(k) Plan with an employer match up to 5 percent of the participant's compensation for eligible employees, which is 100 percent vested with three or more years of service. The 401(k) Plan is a governmental plan and, as such, is specifically exempt from the reporting and disclosure requirements of Title I of the *Employee Retirement Income Security Act of 1974* (ERISA). Total participant contributions were \$31.4 million and \$28.9 million in fiscal years 2019 and 2018, respectively. Total System contributions were \$13.3 million and \$11.7 million in fiscal years 2019 and 2018, respectively.

Forfeitures under the 401(k) Plan for a plan year will be applied to reduce the System's obligation to make future matching contributions or to pay 401(k) Plan administrative expenses for the 401(k) Plan year. During the years ended December 31, 2018 and 2017, System contributions were reduced by approximately \$0.8 million and \$0.9 million, respectively, from forfeited non-vested accounts.

***Pension Plan***

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

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

**Notes to Financial Statements  
February 28, 2019 and 2018**

Each participant shall have a monthly benefit payable for life equal to the greater of (a) the number of years of service multiplied by 1.5 percent of average monthly compensation (average base compensation received in five highest consecutive calendar years out of the 10 complete calendar years prior to retirement) or (b) the accrued monthly retirement benefit determined as of January 1, 1989, plus the number of years of future service earned after January 1, 1989, multiplied by 1.5 percent of average monthly compensation, subject to a minimum equal to the benefit earned under the Plan prior to the adoption of the 6th Amendment as of September 30, 1991 (applies to non-highly compensated employees only). Monthly benefit payments are subject to a minimum based on the number of years of service multiplied by \$6 and a maximum provision permitted to be paid under Section 415 of the Internal Revenue Code. Participants may also elect to receive their benefits in other optional forms approved by the Administrative Committee.

As of January 1, 2018 and 2017, the following employees were covered by the benefit terms:

	<b>2018</b>	<b>2017</b>
Inactive employee or beneficiaries currently receiving benefits	3,047	2,942
Inactive employees entitled to but not yet receiving benefits	1,344	1,366
Active employees	2,469	2,617
	6,860	6,925

The Harris Health System Board of Trustees establishes the contribution requirements of the System based on an actuarially determined rate recommended by an independent actuary. The actuarially determined rate is the estimated amount necessary to finance the costs of benefits earned by employees during the year, with an additional amount to finance any unfunded accrued liability. For the year ended February 28, 2019, the System contributed \$31.0 million or 18 percent of covered payroll. For the year ended February 28, 2018, the System contributed \$29.4 million or 17 percent of covered payroll.

***Net Pension Liability***

The System's net pension liability was measured as of December 31, 2018, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date.

Actuarial assumptions and methods used in the actuarial valuations are as follows.

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

**Notes to Financial Statements  
February 28, 2019 and 2018**

	2018	2017
Valuation date	January 1, 2018	January 1, 2017
Measurement date	December 31, 2018	December 31, 2017
Actuarial cost method	Entry age normal	Entry age normal
Equivalent single amortization period	20 years, closed	20 years, closed
Asset valuation method	Market value	Market value
Actuarial assumptions:		
Inflation	2.5%	3.0%
Investment rate of return (net of expenses)	7.0	7.0
Projected salary increases (ultimate rate):		
Initial rate	5.1	5.1
Ultimate rate	3.0	3.0
Mortality rates:		
Healthy	RP-2014 Total Dataset Mortality Table, adjusted to 2006, with generational mortality improvement of Scale MP-2018	RP-2014 Bottom Quartile Mortality Table, adjusted to 2006, with generational mortality improvement of Scale MP-2017
Disabled	RP-2014 Disability Mortality Table, adjusted to 2006, with generational mortality improvement projected after year 2006 using Scale MP-2018	RP-2014 Disability Mortality Table, adjusted to 2006, with generational mortality improvement projected after year 2006 using Scale MP-2017

The long-term expected rate of return on pension plan investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. The target allocation and best estimates of arithmetic real rates of return as of December 31, 2018, for each major asset class are summarized in the following table:

Asset Class	Target Allocation	Long-Term Expected Real Rate of Return
Real estate funds	5	7.01 %
Domestic equity-large cap	24	8.30
Domestic equity-small/mid cap	4	9.20
International equity	25	8.71
Fixed income	37	5.72
Hedge funds	5	7.48
	<u>100</u> %	

The discount rate used to measure the total pension liability was 7.0 percent, net of expenses, as of December 31, 2018 and 2017. The projection of cash flows used to determine the discount rate assumed that System contributions would be made at rates equal to the actuarial determined contribution and the Plan's fiduciary net position is projected to cover benefit payments and administrative expenses.

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

**Notes to Financial Statements  
February 28, 2019 and 2018**

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

	<b>Increase (Decrease)</b>		
	<b>Total Pension Liability (a)</b>	<b>Plan Fiduciary Net Position (b)</b>	<b>Net Pension Liability (a)-(b)</b>
Balances at December 31, 2017	\$ 866,805	\$ 686,312	\$ 180,493
Changes for the year:			
Service cost	8,280	-	8,280
Interest	60,495	-	60,495
Differences between expected and actual experience	8,000	-	8,000
Changes of assumptions	15,748	-	15,748
Contributions - employer	-	30,984	(30,984)
Net investment income	-	(35,426)	35,426
Benefit payments	(44,712)	(44,712)	-
Administrative expense	-	(2,442)	2,442
Net changes	<u>47,811</u>	<u>(51,596)</u>	<u>99,407</u>
Balance at December 31, 2018	<u>\$ 914,616</u>	<u>\$ 634,716</u>	<u>\$ 279,900</u>

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

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

**Notes to Financial Statements  
February 28, 2019 and 2018**

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

	<b>1% Decrease 6.0%</b>	<b>Current Discount 7.0%</b>	<b>1% Increase 8.0%</b>
System's net pension liability	\$ 386,811	\$ 279,900	\$ 188,999

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

For the fiscal years ended February 28, 2019 and 2018, the System recognized pension expense of \$50.1 million and \$27.9 million, respectively. At February 28, 2019 and 2018, the System reported deferred outflows and deferred inflows of resources related to pension from the following sources (in thousands).

	<b>2019</b>	
	<b>Deferred Outflows of Resources</b>	<b>Deferred Inflows of Resources</b>
Changes of assumptions	\$ 11,538	\$ -
Differences between expected and actual experience	5,026	-
Net difference between projected and actual earnings on pension plan investments	43,558	-
Total	\$ 60,122	\$ 0
	<b>2018</b>	
	<b>Deferred Outflows of Resources</b>	<b>Deferred Inflows of Resources</b>
Changes of assumptions	\$ 6,558	\$ -
Differences between expected and actual experience	1,083	(1,031)
Net difference between projected and actual earnings on pension plan investments	-	(25,937)
Total	\$ 7,641	\$ (26,968)

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

**Notes to Financial Statements  
February 28, 2019 and 2018**

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

Year ended the last day of February:		
2020	\$	28,618
2021		9,584
2022		4,850
2023		17,070
		<hr/>
	\$	60,122
		<hr/> <hr/>

***Deferred Compensation***

The System has a deferred compensation plan for the benefit of its eligible employees under Section 457 of the Internal Revenue Code of 1954. The assets in the Deferred Compensation Plan, which is not recorded in the accompanying statements of net position, are not subject to creditors. The Deferred Compensation Plan assets at February 28, 2019 and 2018, were approximately \$110.7 million and \$105.7 million, respectively.

**Note 10: Other Postemployment Benefits (OPEB) Health Care Plan**

***Plan Description and Benefits Provided***

The OPEB is sponsored by the System which provides certain health care benefits for retired employees. The System's employees may become eligible for those benefits upon completing 10 years of service. Retiree medical plan participants are provided benefits under the System's self-insured medical plan. The contribution requirements of plan members and the System are established by and may be amended by the System's Board of Trustees. The System funds these benefits on a pay-as-you-go basis, meaning that the System will pay benefits as they come due. For fiscal years 2019 and 2018, the System contributed \$21 million and \$20 million, respectively, to the Plan for current premiums and administrative costs. Plan members receiving benefits during fiscal years 2019 and 2018 contributed \$4.2 million and \$3.7 million, respectively, or approximately 20 percent and 19 percent, respectively, of the total premiums, through their required contribution of \$75.83 per month for retiree-only coverage and \$490.60 for retiree and spouse coverage. The OPEB does not issue a separate report that includes financial statements. No assets are accumulated in a trust that meets the criteria in paragraph 4 of GASB Statement 75. At February 28, 2019, the following employees were covered by the benefit terms.

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

**Notes to Financial Statements  
February 28, 2019 and 2018**

Inactive employee or beneficiaries currently receiving benefits	2,072
Active employees	<u>7,698</u>
	<u><u>9,770</u></u>

***Total OPEB Liability***

The System’s total OPEB liability of \$444,321 and expense of \$23,565 was measured as of February 28, 2019, and was determined by an actuarial valuation as of March 1, 2018, and rolled forward to the measurement date.

The total OPEB liability in the February 28, 2019, actuarial valuation report was determined using the following actuarial assumptions and the entry age normal actuarial cost method, applied to all periods included in the measurement, unless otherwise specified:

Salary increases	2.5%
Discount rate	3.21%
Health care cost trend rates	6.75% for 2019, decreasing 0.25% per year to an ultimate rate of 4.75% for 2024 and later years

The discount rate used to measure the total OPEB liability was 3.21 percent which reflects the index rate for 20-year tax-exempt general obligation municipal bonds with an average rating of AA/Aa or higher as of the measurement date as reflected in the Bond Buyer 20-Bond GO index.

Mortality rates for healthy pre-commencement and post- participants were based on RP-2014 bottom quartile mortality tables with generational projected after year 2006 using scale MP-2017. Rates for disabled participants were based on RP-2014 mortality tables for disabled retirees, adjusted to 2006, with generational mortality improvement projected after year 2016 using Scale MP-2017.

No formal actuarial experience studies have been performed.

***Changes in the Total OPEB Liability***

Total OPEB liability, March 1, 2018	<u>\$ 440,928</u>
Changes for the year:	
Service cost	9,746
Interest	13,820
Benefit payments	<u>(20,173)</u>
Net changes	<u>3,393</u>
Total OPEB liability, February 28, 2019	<u><u>\$ 444,321</u></u>

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

**Notes to Financial Statements  
February 28, 2019 and 2018**

***Sensitivity of the System's Total OPEB Liability to Changes in the Discount Rate and Health Care Cost Trend Rates***

The total OPEB liability has been calculated using a discount rate of 3.21 percent. The following table presents the total OPEB liability of the System using a discount rate 1 percent higher and 1 percent lower than the current discount rate.

	<b>1% Decrease (2.21%)</b>	<b>Current Discount Rate (3.21%)</b>	<b>1% Increase (4.21%)</b>
Total OPEB Liability	\$ 510,843	\$ 444,321	\$ 390,764

The following presents the total System's OPEB liability, as well as what the System's OPEB liability would be if it were calculated using health care cost trend rates that are 1 percent higher and 1 percent lower than the current health care cost trend rates.

	<b>1% Decrease</b>	<b>Healthcare Cost Trend Rates (6.75% decreasing to 4.75%)</b>	<b>1% Increase</b>
Total OPEB Liability	\$ 385,349	\$ 444,321	\$ 518,086

***OPEB – GASB No. 45***

Prior to adopting GASB No. 75 in 2019, the System's annual OPEB cost was calculated based on the annual required contribution of the employer (ARC), an amount actuarially determined in accordance with the parameters of GASB No. 45. 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.

As of March 1, 2017, the most recent actuarial valuation date under GASB No. 45, the OPEB was not funded. The actuarial accrued liability for benefits was \$703,044, and the actuarial value of assets was \$0, resulting in an unfunded actuarial accrued liability (UAAL) of \$703,044 and a net OPEB liability (NOL) of \$309,838.

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

**Notes to Financial Statements  
February 28, 2019 and 2018**

**Note 11: Concentrations of Credit Risk**

The System provides services to its patients, most of whom are local residents and may be insured under third-party payor agreements, in accordance with its charity care policy (see Note 2). Patient service revenues (see Note 3) and the related accounts receivable are reflected in the System's financial statements net of charges for charity care provided. The mix of net receivables from self-pay patients and third-party payors at February 28, 2019 and 2018, is as follows:

	<b>2019</b>	<b>2018</b>
Medicaid	17%	16%
Medicare	44%	28%
Commercial	14%	21%
Self-pay patient	25%	35%
	100%	100%

**Note 12: Commitments and Contingencies**

At February 28, 2019 and 2018, 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 Act). Under the Act, any claims and recoveries from pending or possible litigation due to personal injuries are limited to \$100,000 per person and \$300,000 per single occurrence of bodily injury or death. Professional liability claims have been asserted by various claimants. The claims are in various stages of processing, and some may ultimately be brought to trial. There are also other known and unknown incidents that have occurred through February 28, 2019, 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, 2019 and 2018, are as follows (in thousands).

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

**Notes to Financial Statements  
February 28, 2019 and 2018**

	<b>Beginning- of-year Liability</b>	<b>Current-year Claims and Changes In Estimates</b>	<b>Claim Payments</b>	<b>End-of-year Liability</b>
Hospital professional and general liability:				
2019	\$ 1,669	\$ 2,845	\$ 1,926	\$ 2,588
2018	1,230	2,493	2,054	1,669
Workers' compensation liability:				
2019	\$ 2,447	\$ 1,068	\$ 1,139	\$ 2,376
2018	2,261	1,252	1,066	2,447
Employee healthcare benefits liability:				
2019	\$ 10,091	\$ 105,681	\$ 105,993	\$ 9,779
2018	10,096	103,720	103,725	10,091

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

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

At February 28, 2019, the System had commitments outstanding in the amount of approximately \$17.8 million related to improvements at existing facilities and \$7.6 million related to information technology projects.

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

The System had rental expenses related to its operating leases of approximately \$12.4 million and \$11.7 million during the years ended February 28, 2019 and 2018, respectively.

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

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

**Notes to Financial Statements  
February 28, 2019 and 2018**

**Note 13: Harris Collaborative Program**

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

As part of the Harris collaboration, the Affiliated Hospitals formed a Certified Non-Profit Health Organization, Harris County Clinical Services Inc. (HCCS), to provide physician services to the indigent in the Harris County community. HCCS has an agreement with Affiliated Medical Services (AMS), a contracting entity for Baylor College of Medicine (Baylor) and the University of Texas Health Science Center (UT), which provides for Baylor and UT to supervise and direct services of patients of the System. With the creation of the collaborative, the agreement between AMS and HCCS was created in order to provide the physician services to indigent patients who seek treatment. In addition, HCCS also entered into agreements with other health care service providers to extend services available. Through its agreements with AMS and other providers, HCCS provides approximately \$243 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, 2019 and 2018, the System utilized \$223.0 million and \$180.4 million of tax revenues, respectively, as the nonfederal share of the Harris Collaborative program. The System recorded expenses of \$204.0 million and \$207.2 million in 2019 and 2018, respectively, under the Harris Collaborative program and provider affiliation agreements. These expenses are reflected as physician services in the statements of revenues, expenses and changes in net position.

## **Required Supplementary Information**

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

**Schedule of Changes in the System's Net Pension Liability and Related Ratios  
(Dollar amounts in thousands)**

	Plan Year Ended December 31,				
	2018	2017	2016	2015	2014
Total pension liability:					
Service cost	\$ 8,280	\$ 6,803	\$ 7,232	\$ 7,795	\$ 8,642
Interest	60,495	61,427	59,397	57,482	52,342
Difference between expected and actual experience	8,000	1,718	(4,063)	4,637	(1,909)
Changes of assumptions	15,748	10,709	-	-	40,689
Benefit payments	(44,712)	(42,563)	(40,178)	(44,023)	(34,444)
Net change in total pension liability	47,811	38,094	22,388	25,891	65,320
Total pension liability – beginning	866,805	828,711	806,323	780,432	715,112
Total pension liability – ending (a)	914,616	866,805	828,711	806,323	780,432
Plan fiduciary net position:					
Contributions – employer	30,984	29,433	32,693	31,759	31,292
Net investment income	(35,426)	107,519	37,401	(4,891)	37,069
Benefit payments	(44,712)	(42,563)	(40,178)	(44,023)	(34,444)
Administrative expense	(2,442)	(2,478)	(232)	(2,389)	(2,302)
Net change in plan fiduciary net position	(51,596)	91,911	29,684	(19,544)	31,615
Plan fiduciary net position – beginning	686,312	594,401	564,717	584,261	552,646
Plan fiduciary net position – ending (b)	634,716	686,312	594,401	564,717	584,261
System's net pension liability – ending (a) – (b)	\$ 279,900	\$ 180,493	\$ 234,310	\$ 241,606	\$ 196,171
Plan fiduciary net position as a percentage of the total pension liability	69.40%	79.18%	71.70%	70.04%	74.86%
Covered payroll	\$ 169,885	\$ 173,272	\$ 182,060	\$ 197,360	\$ 210,728
System's net pension liability as a percentage of covered payroll	164.76%	104.16%	128.68%	122.42%	93.09%

Notes to Schedule:

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

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

*Changes of assumptions* – In 2018, amounts reported as changes of assumptions resulted primarily from adjustments to assumed life expectancies as a result of adopting the RP-2014 total dataset mortality tables with generational mortality improvement projected after 2006 using Scale MP-2018 for purposes of developing mortality rates and change in inflation rate from 3.0% to 2.5%.

**Harris County Hospital District,  
d/b/a Harris Health System,  
A Component Unit of Harris County, Texas  
Schedule of System Pension Contributions  
January 1, 2019**

	Plan Year Ended December 31,				
	2018	2017	2016	2015	2014
Actuarially determined contribution	\$ 30,984	\$ 29,433	\$ 32,693	\$ 31,759	\$ 31,292
Contributions in relation to the actuarially determined contribution	30,984	29,433	32,693	31,759	31,292
Contribution deficiency (excess)	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>
Covered payroll	\$ 169,885	\$ 173,272	\$ 182,060	\$ 197,360	\$ 210,728
Contributions as a percentage of covered payroll	18.24%	17.00%	17.96%	16.09%	14.85%

Notes to Schedule:

*Valuation date:*

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

*Methods and assumptions used to determine contribution rates:*

Actuarial cost method	Entry age normal
Amortization method	Layered over a closed 20-year period
Remaining amortization period	16 years
Asset valuation method	Market value, 5-year smoothing
Inflation	2.5%
Salary increases	5.1% initial rate 3.0% ultimate rate
Investment rate of return	7.0%, net of pension plan investment expense, including inflation
Retirement age	Various – Expected retirement ages are adjusted to more closely reflect actual experience
Mortality	RP-2014 Total Dataset Mortality table, adjusted to 2006, with generational mortality improvement projected after year 2006 with Scale MP-2018.

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

**Schedule of Changes in the System's Total OPEB Liability and Related Ratios  
Year Ended February 28, 2019  
(Dollar amounts in thousands)**

	<b>2019</b>
<b>Total OPEB liability:</b>	
Service cost	\$ 9,746
Interest	13,820
Benefit payments	(20,173)
<b>Net change in total OPEB liability</b>	3,393
Total OPEB liability – beginning	440,928
Total OPEB liability – ending	\$ 444,321
Covered employee payroll	\$ 491,810
System's total OPEB liability as a percentage of covered payroll	90.30%

Notes to Schedule:

*Changes of assumptions* – Change in discount rate from 4% in 2018 to 3.21% in 2019.

This schedule is presented as of the measurement date which is as of the fiscal year-end.