



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

Financial Statements

February 28, 2015 and 2014

(With Independent Auditors' Report Thereon)

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

**Table of Contents**

	<b>Page(s)</b>
Independent Auditors' Report	1-2
Management's Discussion and Analysis (Unaudited)	3-12
Financial Statements as of and for the years ended February 28, 2015 and 2014:	
Statements of Net Position	13-14
Statements of Revenues, Expenses, and Changes in Net Position	15
Statements of Cash Flow	16-17
Notes to Financial Statements	18-47
<b>Required Supplementary Information</b>	
Schedule of Funding Progress of Defined Benefit Pension Plan (Unaudited)	48
Schedule of Actuarial Data for Defined Benefit Pension Plan (Unaudited)	49
Schedule of Funding Progress of Other Postemployment Benefit Plan (Unaudited)	50



KPMG LLP  
811 Main Street  
Houston, TX 77002

## Independent Auditors' Report

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

We have audited the accompanying financial statements of the business-type activities and the aggregate discretely presented component units of Harris County Hospital District, dba Harris Health System (the System), a component unit of Harris County, Texas, as of and for the years ended February 28, 2015 and 2014, and the related notes to the financial statements, which collectively comprise the System's basic financial statements as listed in the table of contents. We did not audit the financial statements of the Harris County Hospital District Foundation, a discretely presented component unit, which represent 15.8%, 26.0%, and 0.8% of the 2015 and 17.1%, 27.7%, and 1.2% of the 2014 assets, net position, and revenues of the aggregate discretely presented component units, respectively. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for the Harris County Hospital District Foundation, is based solely on the report of the other auditor.

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

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

### *Auditors' Responsibility*

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement. The financial statements of the Harris County Hospital District Foundation and Community Health Choice, Inc. were not audited in accordance with *Government Auditing Standards*.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.



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

***Opinion***

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities and the aggregate discretely presented component units of Harris Health System, as of February 28, 2015 and 2014, and the respective changes in financial position, and cash flows thereof for the years then ended in accordance with U.S. generally accepted accounting principles.

***Other Matters***

***Required Supplementary Information***

U.S. generally accepted accounting principles require that the management's discussion and analysis and supplementary schedules on pages 3–12 and 48-50, respectively, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

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

In accordance with *Government Auditing Standards*, we have also issued our report dated June 12, 2015 on our consideration of the System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the System's internal control over financial reporting and compliance.

**KPMG LLP**

Houston, Texas  
June 12, 2015

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

Management's Discussion and Analysis

February 28, 2015 and 2014

(Unaudited)

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, 2015 and 2014. 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 \$17 million (2.4%) and \$22 million (3.0%) in fiscal 2015 and fiscal 2014, respectively.
- Total assets and deferred outflows decreased approximately \$4 million (0.3%) between fiscal 2014 and fiscal 2015. Total assets and deferred outflows decreased approximately \$4 million (0.3%) between fiscal 2013 and fiscal 2014.
- Long-term debt, including current portion, decreased approximately \$5 million (1.7%) in fiscal 2015 and decreased approximately \$7 million (2.4%) in fiscal 2014. Other liabilities increased approximately \$18 million (4.3%) in fiscal 2015 due to increased outstanding commitments related to post employment health benefits and approximately \$25 million (6.3%) in fiscal 2014 as a result of outstanding commitments under the Harris Collaborative Program and the System's post employment health benefits plan.
- Community Health Choice, Inc. experienced a 10.2% growth in membership during fiscal 2015 and 3.7% growth in membership during fiscal 2014.
- The number of unduplicated patients served by the System increased 3.5% and 3.3% in fiscal 2015 and 2014, respectively. Services provided on an inpatient basis increased 2.8% in fiscal 2015 versus an increase of 4.0% in inpatient services provided in fiscal 2014 as compared to 2013. Emergency care/urgent visits increased 2.8% and 2.0% in fiscal 2015 and 2014, respectively.

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

Management's Discussion and Analysis

February 28, 2015 and 2014

(Unaudited)

- Access to surgical services and appointment availability for primary care and specialty clinic visits continue to be a challenge. In fiscal 2014, the System began partnering with Federally Qualified Health Centers, outside physician groups, and surgical facilities to increase capacity. In fiscal 2015, the System also opened eight additional clinics and three additional operating rooms. As a result, the System has experienced increases in primary care and specialty care visits provided, as well as surgery cases.

	<u>Fiscal 2015</u>	<u>Fiscal 2014</u>	<u>Percent change</u>	<u>Fiscal 2013</u>	<u>Percent change</u>
Primary Care Visits	886,904	806,615	10.0%	786,034	2.6%
Referred Primary Care	6,140	10,451	(41.2)%	4,380	138.6%
Total	<u>893,044</u>	<u>817,066</u>	<u>9.3%</u>	<u>790,414</u>	<u>3.4%</u>
Specialty Care Visits	344,867	335,570	2.8%	306,163	9.6%
Referred Specialty Care	1,033	308	235.4%	—	100.0%
Total	<u>345,900</u>	<u>335,878</u>	<u>3.0%</u>	<u>306,163</u>	<u>9.7%</u>
Surgery Cases – Inpatient	11,472	11,200	2.4%	11,246	(0.4)%
Surgery Cases – Outpatient	10,593	9,830	7.8%	10,123	(2.9)%
Surgery Cases – Referred	1,646	1,712	(3.9)%	926	84.9%
Total	<u>23,711</u>	<u>22,742</u>	<u>4.3%</u>	<u>22,295</u>	<u>2.0%</u>

- During fiscal 2015 and 2014, the System invested \$44 million and \$95 million, respectively, in space/facility expansion projects, critical information technology, and medical equipment. Significant capital acquisitions and resource investments included the following:

Information Technology including clinical effectiveness tools, healthcare analytics and disease management, ambulatory pharmacy, and operating room management.

In fiscal 2015, the System completed most of the projects under a multi-year plan of space and facility expansion projects embarked on in 2008. Expansion of outpatient ancillary services during fiscal 2015 and 2014 included:

- Eight outlying primary care clinic campuses in fiscal 2015 and two in fiscal 2014
- Three operating suites with an additional two scheduled to open the first half of fiscal 2016
- Semi-private room renovations at the Ben Taub campus

- The Harris County Hospital District Foundation's multi-year Capital Campaign raised more than \$23 million in gifts and commitments for the space and facility expansion projects. Campaign contributions totaling \$0.5 million were distributed to the System during fiscal year 2015 and \$10.8 million during fiscal years 2013 through 2014.

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

Management's Discussion and Analysis

February 28, 2015 and 2014

(Unaudited)

**Financial Statements**

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

**Net Position**

**Table 1**  
**Condensed Statements of Net Position**

(In millions)

	<u>2015</u>	<u>2014</u>	<u>Dollar change</u>	<u>Total percentage change</u>	<u>(Restated) 2013</u>	<u>Dollar change</u>	<u>Total percentage change</u>
Assets:							
Current and other assets	\$ 942	945	(3)	(0.3)%	\$ 979	(34)	(3.5)%
Capital assets	454	467	(13)	(2.8)	425	42	9.9
Total assets	<u>1,396</u>	<u>1,412</u>	<u>(16)</u>	<u>(1.1)%</u>	<u>1,404</u>	<u>8</u>	<u>0.6%</u>
Deferred outflows of resources:							
Derivative financial instrument	13	—	13	100%	10	(10)	(100.0)%
Unamortized loss on refunding debt	14	15	(1)	(6.7)	17	(2)	(11.8)
Total deferred outflows	<u>27</u>	<u>15</u>	<u>12</u>	<u>80.0%</u>	<u>27</u>	<u>(12)</u>	<u>(44.4)%</u>
Total assets and deferred outflows	<u>\$ 1,423</u>	<u>1,427</u>	<u>(4)</u>	<u>(0.3)%</u>	<u>\$ 1,431</u>	<u>(4)</u>	<u>(0.3)%</u>

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

Management's Discussion and Analysis

February 28, 2015 and 2014

(Unaudited)

**Table 1  
Condensed Statements of Net Position**

(In millions)

	<u>2015</u>	<u>2014</u>	<u>Dollar change</u>	<u>Total percentage change</u>	<u>(Restated) 2013</u>	<u>Dollar change</u>	<u>Total percentage change</u>
Liabilities:							
Long-term debt outstanding	\$ 281	286	(5)	(1.7)%	\$ 293	(7)	(2.4)%
Other liabilities	439	421	18	4.3	396	25	6.3
Total liabilities	<u>720</u>	<u>707</u>	<u>13</u>	<u>1.8%</u>	<u>689</u>	<u>18</u>	<u>2.6%</u>
Deferred inflows of resources	<u>—</u>	<u>—</u>	<u>—</u>	<u>0.0%</u>	<u>—</u>	<u>—</u>	<u>0.0%</u>
Total liabilities and deferred inflows	<u>\$ 720</u>	<u>707</u>	<u>13</u>	<u>1.8%</u>	<u>\$ 689</u>	<u>18</u>	<u>2.6%</u>
Net investment in capital assets	\$ 173	181	(8)	(4.4)%	\$ 135	46	34.1%
Restricted	31	31	—	—	32	(1)	(3.1)
Unrestricted	<u>499</u>	<u>508</u>	<u>(9)</u>	<u>(1.8)</u>	<u>575</u>	<u>(67)</u>	<u>(11.7)</u>
Total net position	<u>\$ 703</u>	<u>720</u>	<u>(17)</u>	<u>(2.4)%</u>	<u>\$ 742</u>	<u>(22)</u>	<u>(3.0)%</u>

GASB Statement 65, implemented in 2014, modified the presentation of deferred inflows and deferred outflows and changed the statement of net position previously presented, including the required write off of certain prepaid bond issuance costs that were previously classified as other noncurrent assets and amortized as a component of depreciation/amortization expense and also presented unamortized loss on refunding debt that was previously presented as a reduction of long term debt as a deferred outflow of resources. As a result, the statement of net position for fiscal year 2013 summarized above has been restated to reflect the changes necessitated by the GASB.

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 \$17 million in fiscal 2015. The overall decrease is the result of the loss reported for fiscal 2015. In fiscal 2014, net position decreased \$22 million as a result of the loss reported for the year. The loss reported for fiscal 2015 and 2014 is discussed in detail following Table 2. Current and other assets decreased \$3 million or 0.3% from fiscal 2014 to fiscal 2015, and decreased \$34 million or 3.5% from fiscal 2013 to fiscal 2014. The decrease in fiscal 2014 is primarily due to the expenditure of funds for the space and expansion projects. In 2015, as funding increased from patient services and ad valorem taxes, the expenditures for expansion projects slowed. Capital assets are discussed in detail following Table 3. Deferred outflows of resources consist of the fair market value of derivatives and unamortized losses on refunding of debt. Deferred outflows related to hedging derivatives increased \$13 million in 2015 and decreased \$10 million in 2014 with an offsetting change in derivative liability.



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

Management's Discussion and Analysis

February 28, 2015 and 2014

(Unaudited)

In fiscal 2015 and 2014, reductions in bond-related debt reflect scheduled debt service payments. The System's net obligation for the provision of certain post-employment healthcare benefits increased approximately \$21.6 million during fiscal 2015 and \$22 million during fiscal 2014. Obligations under the Harris Collaborative Program were \$8.2 million less at February 28, 2015 than 2014. The reported derivative liability associated with an interest rate swap increased \$12.8 million at February 28, 2015 as compared to February 28, 2014. Other routine operating liabilities were approximately \$13.5 million less at February 28, 2015 than 2014.

In December of 2011, Texas received federal approval to redirect the upper payment limit program funding it would have received over the next five years into a new reform plan (1115 Waiver). The System had recorded receivables of \$219.9 million and \$243.5 million at February 28, 2015 and 2014, respectively, related to these Medicaid supplemental programs. Medicaid supplemental programs revenue recorded in fiscal 2015 included an unfavorable adjustment of \$0.3 million for prior years' programs. The February 2015 receivable includes \$129.0 million and \$90.8 million related to the 2014 and 2015 program years, respectively.

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

The following table summarizes the System's revenues and expenses for each of the years ended February 28, 2015, 2014 and 2013, 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)

	<u>2015</u>	<u>2014</u>	<u>(Restated) 2013</u>
Operating revenues:			
Net patient service revenue	\$ 365,636	348,605	294,778
Medicaid supplemental programs revenues	235,758	255,894	272,445
Other operating revenues	28,490	23,130	25,360
Total operating revenues	<u>629,884</u>	<u>627,629</u>	<u>592,583</u>
Operating expenses:			
Salaries, wages, and benefits	710,047	707,335	662,389
Purchased services, supplies, and other	516,632	495,585	439,008
Depreciation and amortization	56,672	52,173	51,465
Total operating expenses	<u>1,283,351</u>	<u>1,255,093</u>	<u>1,152,862</u>
Operating loss	<u>(653,467)</u>	<u>(627,464)</u>	<u>(560,279)</u>

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

Management's Discussion and Analysis

February 28, 2015 and 2014

(Unaudited)

**Table 2**  
**Condensed Summary of Revenues, Expenses, and Changes in Net Position**

(In thousands)

	<u>2015</u>	<u>2014</u>	<u>(Restated) 2013</u>
Nonoperating revenues:			
Ad valorem tax revenues – net	\$ 574,274	515,990	508,424
DSRIP	59,558	90,122	—
Tobacco settlement revenues	9,512	9,774	9,719
Investment income	5,010	876	4,730
Other	2,465	442	3,167
Total nonoperating revenues	<u>650,819</u>	<u>617,204</u>	<u>526,040</u>
Nonoperating expenses:			
Interest expense	(14,372)	(11,940)	(7,055)
Other	(42)	(6)	(19)
Total nonoperating expenses	<u>(14,414)</u>	<u>(11,946)</u>	<u>(7,074)</u>
(Loss) income before other revenues, expenses, gains, losses, and transfers	(17,062)	(22,206)	(41,313)
Capital contributions	—	—	10,272
Change in net position	(17,062)	(22,206)	(31,041)
Total net position – beginning of year, as restated	<u>720,158</u>	<u>742,364</u>	<u>773,405</u>
Total net position – end of year	<u>\$ 703,096</u>	<u>720,158</u>	<u>742,364</u>

**Revenues**

During the year ended February 28, 2015, the System's total operating revenue increased by \$2.3 million (0.4%). Operating revenues increased \$35 million (5.9%) during the year ended February 28, 2014.

- Net patient service revenue increased \$17 million in fiscal 2015 and \$53.8 million in fiscal 2014 due to increased service volumes and reimbursement from third party payors and patients.
- With the implementation of the 1115 Waiver in 2011, estimated revenues increased \$39.5 million in fiscal 2012 and \$48.1 million in fiscal 2013 due to the inclusion of additional uncompensated care costs that were not previously recoverable. During fiscal year 2014, the estimated revenues related to the Federal Fiscal Year 2013 ended September 30, 2013 were lowered and as a result Medicaid supplemental programs revenues for 2014 reflect a \$16.5 million decrease as compared to fiscal 2013. Fiscal 2015 reflects a \$20.1 million decrease as compared to 2014.

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

Management's Discussion and Analysis

February 28, 2015 and 2014

(Unaudited)

- Other operating revenues, including funding received under the electronic health record incentive programs, increased \$5.4 million in fiscal 2015 and decreased \$2.2 million in fiscal 2014 as compared to fiscal 2013.

**Operating Expenses**

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

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

During the year ended February 28, 2014, total operating expenses increased \$102.2 million (8.9%).

- System salaries and wages increased \$34.3 million (7.0%). The compensation plan remained competitive with merit increases and an average salary increase of 1.4%. Total staffing increased 5.6% with a productivity improvement of 2.0%.
- Related benefits increased \$10.6 million (6.1%) due to increases in employee retirement plan costs.
- Purchased medical services, supplies, and other operating expenses increased 12.9%, primarily as a result of increased service volumes and costs incurred under the Harris Collaborative Program.

Overall, the System's operating loss increased 4.1% from 2014 to 2015 and increased 12.0% from 2013 to 2014 as a result of the items discussed above. The System receives property tax revenues to subsidize the cost of services provided to qualified uninsured patients. Although the costs incurred to provide these services are reflected above as operating expenses, the property tax revenues are required to be reported as nonoperating revenues.

Nonoperating revenues and expenses consist of revenues and expenses related to financing and investing types of activities, including grants and donations for activities not considered as operating activities, and include property tax revenue, investment income, tobacco settlement funds, 1115 Waiver delivery system reform incentive payment program (DSRIP), interest expense, gains or losses on disposal of assets, and certain grants and donations. Tax revenues, net of related expenses, increased \$58.3 million, or 11.3%, in 2015 and \$7.6 million in fiscal 2014, or 1.5%. Investment income increased \$4.1 million in fiscal 2015 compared to a decrease of \$3.9 million reported for fiscal 2014. The System received approximately \$9.5 million and \$9.8 million in tobacco settlement revenue in fiscal year 2015 and 2014, respectively. Nonoperating grants and donations and gains/losses on disposal of assets totaled \$2.5 million in fiscal 2015 compared to \$0.4 million in fiscal 2014. The System received \$59.6 million in fiscal 2015 and \$90.1 million in fiscal 2014 under the DSRIP.

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

Management's Discussion and Analysis

February 28, 2015 and 2014

(Unaudited)

**Capital Assets and Debt Financing**

During fiscal 2015 and 2014, the System invested \$44 million and \$95 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, 2015, 2014, and 2013:

**Table 3**

**Changes in Capital Assets**

(In thousands)

	<u>2015</u>	<u>2014</u>	<u>Dollar change</u>	<u>Total percentage change</u>	<u>2013</u>	<u>Dollar change</u>	<u>Total percentage change</u>
Land and improvements	\$ 41,468	41,059	409	1.0%	\$ 39,100	1,959	5.0%
Buildings and fixed equipment	590,801	566,189	24,612	4.3	477,767	88,422	18.5
Major movable equipment	340,820	334,804	6,016	1.8	311,390	23,414	7.5
Subtotal	973,089	942,052	31,037	3.3	828,257	113,795	13.7
Less accumulated depreciation	(540,584)	(507,000)	(33,584)	6.6	(467,803)	(39,197)	8.4
Construction in progress	21,599	31,652	(10,053)	(31.8)	64,930	(33,278)	(51.3)
Capital assets – net	<u>\$ 454,104</u>	<u>466,704</u>	<u>(12,600)</u>	<u>(2.7)%</u>	<u>\$ 425,384</u>	<u>41,320</u>	<u>9.7%</u>

In 2008, the System embarked on a multi-year plan in capital projects for the expansion of existing diagnostic and treatment facilities to improve access to healthcare services. Most of these projects have been completed. It is anticipated that additional funds of \$5.6 million will be expended in the upcoming year.

Annually, the System conducts an assessment of its facilities, equipment, and technology to determine the priorities for replacement, repair, and any new acquisitions. The assessment and prioritization process addresses obsolescence, new technology, building safety, and code compliance requirements. As a result, the System's capital plan for fiscal year 2016 includes an investment of \$35.8 million in routine capital expenditures. The capital projects include \$8.9 million in information technology primarily dedicated to current system upgrades and technology refresh, \$8.3 million specific to medical capital, and \$18.5 million in renovations of current facilities. An additional \$5.6 million is dedicated to the remaining expansion projects.

At February 28, 2015 and 2014, the System had \$280.7 million and \$285.9 million, respectively, in outstanding revenue bonds. In October 2007, the System issued Series 2007A refunding and revenue bonds to refund \$24 million in outstanding commercial paper debt, to provide funding for expansion and renovation projects totaling \$158 million and to fund the required debt service reserve fund. In October 2007, the System also refunded and refinanced the Series 2000 revenue bonds with the issuance of Series 2007B Bonds in the amount of \$103.5 million. The bonds were initially issued as 28-day taxable auction-rate paper converting to tax exempt in August of 2010. Subsequent to the 2008 fiscal year-end, the auction-rate paper was converted to taxable fixed rate bonds. In August 2010, the System refunded and refinanced the Series 2007B Bonds by issuing Series 2010

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

Management's Discussion and Analysis

February 28, 2015 and 2014

(Unaudited)

refunding and revenue bonds in the amount of \$104,435,000. The Series 2010 Bonds financed the refunding of the 2007B Bonds and costs of issuance and are tax exempt. The Series B Bonds were hedged with a forward starting swap effective upon the tax-exempt conversion of the Bonds. In order to obtain a substantially fixed rate for the 2007B debt service requirements, a Qualified Hedge Agreement was executed between the Harris County Hospital District and Siebert Brandford Shank & Co. and the Harris County Hospital District and Bank of America. In fiscal 2014, the agreement was assigned and assumed by Deutsche Bank as the credit support provider for Siebert Brandford Shank & Co. The swap became effective August 16, 2010 upon issuance of the Series 2010 Refunding Bonds. On that date, the interest rate swap was redesignated to the new debt and an off market element totaling \$17,546,000 to the swap was created. In accordance with Governmental Accounting Standards Board (GASB) Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, this off-market element is recorded as a borrowing payable and is being amortized as an adjustment to interest expense over the life of the swap agreement. The 2007B Bonds were defeased through the irrevocable deposit of sufficient funds with trustees to pay the principal and interest of such bonds through maturity. Moody's and Standard & Poor's have an underlying rating of A2/A on the revenue bond obligations. The debt is scheduled to be repaid in 2042. The debt is issued in the name of the Harris County Hospital District. Any issuance of debt requires the approval of the System's Board of Managers and the Harris County Commissioners' Court. Table 4 below summarizes the System's debt obligations at February 28, 2015, 2014, and 2013:

**Table 4  
Long-Term Debt and Other Long-Term Obligations**

(In thousands)

	<u>2015</u>	<u>2014</u>	<u>2013</u>
Series 2007 tax-exempt revenue bonds	\$ 184,655	187,830	190,855
Series 2010 revenue bonds	96,005	98,025	99,985
Borrowing payable – interest rate swap	13,571	14,417	15,280
Derivative liability	13,040	271	10,057
Other long – term obligations	<u>623</u>	<u>845</u>	<u>1,182</u>
Total long-term debt and other long-term obligations	307,894	301,388	317,359
Less current portion	<u>(5,599)</u>	<u>(5,445)</u>	<u>(5,877)</u>
Noncurrent portion	<u>\$ 302,295</u>	<u>295,943</u>	<u>311,482</u>

The System's long-term debt and short-term debt ratings at February 28, 2015 and 2014 were "AA" and "F1".

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

Management's Discussion and Analysis

February 28, 2015 and 2014

(Unaudited)

**Economic Conditions and Plan for Fiscal 2016**

In planning for fiscal 2016, the primary concerns were the same as prior year – the uncertain status of the economy at both the federal and state funding levels and the uncertainty of federal healthcare reform efforts and their potential financial and operational impact on the System. Issues that need to be monitored on an ongoing basis throughout the year include the following:

- Continuing growth in Harris County, and the demand for services by the uninsured population, and the capacity of the System at both a physical plant capacity level and staffing availability level
- Clinical throughput, including inpatient and outpatient surgical capabilities
- Constrained capacity at the Level 1 emergency center
- Current and future funding available under the Medicaid Supplemental programs and resulting significant cash flow fluctuations
- Property tax funding and the valuation of properties within Harris County
- Increased cost of continuing expansion of services and efforts to reduce expenses
- Routine plant and equipment needs for replacement of aged equipment, and needed repairs, maintenance, and renovation
- Cost savings and efficiencies available under the Harris County Collaborative and the new Texas 1115 Waiver Program or DSRIP
- Advancement in the System's key strategic priorities of:
  - Meeting community needs through improved access to care,
  - Providing high-quality healthcare,
  - Improving patient, physician, and employee satisfaction,
  - Hiring and retaining excellent employees, and
  - Positioning the System to succeed in an evolving healthcare reform environment
- Maintenance of financial strength and stable cash positions.

**Contacting the System's Financial Management**

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

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

Statements of Net Position

February 28, 2015 and 2014

(In thousands)

	2015			2014		
	Component units			Component units		
	Harris Health System	Foundation	Community Health Choice Inc.	Harris Health System	Foundation	Community Health Choice Inc.
<b>Assets and Deferred Outflows of Resources</b>						
Current assets:						
Cash and cash equivalents	\$ 160,319	778	28,883	173,716	999	13,182
Short-term investments (notes 5 and 6)	347,367	—	101,516	46,749	—	107,777
Accounts receivable – net of allowance for uncollectible accounts of \$98,083 and \$78,219 (note 10)	76,653	—	—	80,204	—	—
Current portion of ad valorem taxes receivable – net of allowance for uncollectible taxes of \$5,760 and \$5,181	26,288	—	—	24,682	—	—
Inventories	12,458	—	—	10,202	—	—
Medicaid supplemental programs receivable	219,851	—	—	243,537	—	—
Prepaid expenses and other current assets	12,382	783	17,035	9,491	870	19,140
Estimated third-party payor settlements	2,553	—	—	3,757	—	—
Due from Community Health Choice, Inc.	4,746	—	—	4,525	—	—
Current portion of assets limited as to use or restricted (notes 5 and 6)	6,041	—	—	41,146	—	—
Total current assets	868,658	1,561	147,434	638,009	1,869	140,099
Assets limited as to use or restricted – net of current portion: (notes 5 and 6)						
Debt service	24,709	—	—	24,521	—	—
Capital expansion	—	—	—	100,082	—	—
Self-insured programs and other	822	23,104	—	178,090	20,821	—
Total assets limited as to use or restricted – net	25,531	23,104	—	302,693	20,821	—
Capital assets (notes 7 and 11):						
Land and improvements	41,468	—	—	41,059	—	—
Buildings and fixed equipment	590,801	—	—	566,189	—	—
Major movable equipment	340,820	—	—	334,804	—	—
Less accumulated depreciation	(540,584)	—	—	(507,000)	—	—
Total depreciable capital assets – net	432,505	—	—	435,052	—	—
Construction in progress	21,599	—	—	31,652	—	—
Capital assets – net	454,104	—	—	466,704	—	—
Other assets:						
Ad valorem taxes receivable – net of current portion and allowance for uncollectible taxes of \$41,325 and \$46,244	313	—	—	552	—	—
Net pension asset (note 9)	2,180	—	—	2,231	—	—
Long-term investments (note 6)	43,957	—	47,465	—	—	29,342
Prepaid debt insurance	1,463	—	—	1,551	—	—
Other assets	70	11,824	—	70	12,209	—
Total other assets	47,983	11,824	47,465	4,404	12,209	29,342
Deferred outflows of resources:						
Derivative financial instrument	13,040	—	—	271	—	—
Loss on Series 2010 Refunding Revenue Bonds	13,480	—	—	15,224	—	—
Total deferred outflows of resources	26,520	—	—	15,495	—	—
Total assets and deferred outflows of resources \$	1,422,796	36,489	194,899	1,427,305	34,899	169,441

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

Statements of Net Position

February 28, 2015 and 2014

(In thousands)

	2015			2014		
	Component units			Component units		
	Harris Health System	Foundation	Community Health Choice, Inc.	Harris Health System	Foundation	Community Health Choice, Inc.
<b>Liabilities, Deferred Inflows of Resources, and Net Position</b>						
Current liabilities:						
Accounts payable and accrued liabilities	\$ 121,517	207	13,577	143,230	404	11,761
Interest payable	628	—	—	636	—	—
Employee compensation and related benefit liabilities (note 11)	26,789	—	—	25,618	—	—
Post employment health benefit liability (note 9)	15,738	—	—	14,615	—	—
Compensated absences	39,977	—	—	41,047	—	—
Medical claims liability (note 2)	—	—	72,227	—	—	62,430
Due to Harris Health System	—	—	5,851	—	—	5,059
Estimated third-party payor settlements	9,498	—	—	3,386	—	—
Current portion of long-term debt and capital leases (note 8)	5,599	—	—	5,445	—	—
Total current liabilities	219,746	207	91,655	233,977	404	79,250
Other long-term liabilities:						
Postemployment health benefit liability (note 9)	197,659	—	—	177,227	—	—
Borrowing payable (note 8)	13,571	—	—	14,417	—	—
Derivative liability	13,040	—	—	271	—	—
Other	151	—	—	151	—	—
Long-term debt (note 8):						
Series 2007 revenue bonds	181,320	—	—	184,655	—	—
Series 2010 revenue bonds	93,925	—	—	96,005	—	—
Other long-term obligations – capital leases	288	—	—	444	—	—
Total liabilities	719,700	207	91,655	707,147	404	79,250
Deferred inflows of resources	—	—	—	—	—	—
Commitments and contingencies (note 11)						
Net position:						
Net investment in capital assets	172,900	—	—	180,962	—	—
Restricted for debt service	31,572	—	—	31,215	—	—
Restricted – other	—	27,281	—	—	26,900	—
Unrestricted	498,624	9,001	103,244	507,981	7,595	90,191
Total net position	703,096	36,282	103,244	720,158	34,495	90,191
Total liabilities, deferred inflows of resources, and net position	\$ 1,422,796	36,489	194,899	1,427,305	34,899	169,441

See accompanying notes to financial statements.



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

Statements of Revenues, Expenses, and Changes in Net Position

Years ended February 28, 2015 and 2014

(In thousands)

	2015			2014		
	Component units			Component units		
	Harris Health System	Foundation	Community Health Choice, Inc.	Harris Health System	Foundation	Community Health Choice, Inc.
Operating revenues:						
Net patient service revenue (note 3)	\$ 365,636	—	—	348,605	—	—
Medicaid supplemental programs revenue (note 4)	235,758	—	—	255,894	—	—
Premium revenue	—	—	725,928	—	—	668,370
Other operating revenues	28,490	1,968	173	23,130	2,292	210
Total operating revenues	629,884	1,968	726,101	627,629	2,292	668,580
Operating expenses:						
Salaries, wages, and benefits	710,047	665	32,812	707,335	554	28,281
Pharmaceuticals and supplies	211,840	15	1,727	197,888	16	1,293
Physician services (note 12)	192,966	—	—	180,485	—	—
Medical claims expense	—	—	644,120	—	—	615,144
Other purchased services	111,826	2,956	32,049	117,212	3,509	27,828
Depreciation and amortization	56,672	—	—	52,173	—	—
Total operating expenses	1,283,351	3,636	710,708	1,255,093	4,079	672,546
Operating (loss) income	(653,467)	(1,668)	15,393	(627,464)	(1,787)	(3,966)
Nonoperating revenues (expenses):						
Ad valorem tax revenues – net	574,274	—	—	515,990	—	—
DSRIP	59,558	—	—	90,122	—	—
Tobacco settlement revenues	9,512	—	—	9,774	—	—
Investment income (loss)	5,010	3,625	1,160	876	6,164	(54)
Interest expense (note 8)	(14,372)	—	—	(11,940)	—	—
Other	2,423	(170)	(3,500)	436	(120)	—
Total nonoperating revenues (expenses) – net	636,405	3,455	(2,340)	605,258	6,044	(54)
Changes in net position	(17,062)	1,787	13,053	(22,206)	4,257	(4,020)
Net position – beginning of year	720,158	34,495	90,191	742,364	30,238	94,211
Net position – end of year	\$ 703,096	36,282	103,244	720,158	34,495	90,191

See accompanying notes to financial statements.

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

Statements of Cash Flows

Years ended February 28, 2015 and 2014

(In thousands)

	<u>2015</u>	<u>2014</u>
	<u>Harris Health</u>	<u>Harris Health</u>
	<u>System</u>	<u>System</u>
Operating activities:		
Receipts from and on behalf of patients	\$ 379,660	334,754
Receipts from Medicaid supplemental programs	259,444	205,365
Receipts from incentive programs and grants	11,883	14,857
Receipts from other revenues	11,527	7,261
Payments to suppliers	(528,486)	(469,824)
Payments to employees and for employee benefits	(688,340)	(700,483)
Net cash used in operating activities	<u>(554,312)</u>	<u>(608,070)</u>
Noncapital financing activities:		
Contributions – net	2,500	687
Ad valorem taxes – net	573,837	513,890
DSRIP revenues	59,558	90,122
Tobacco settlement revenues	9,512	9,774
Net cash provided by noncapital financing activities	<u>645,407</u>	<u>614,473</u>
Capital and related financing activities:		
Acquisitions and construction of capital assets	(56,921)	(90,877)
Interest paid	(13,837)	(14,094)
Repayment of long-term debt	(5,417)	(5,925)
Net cash used in capital and related financing activities	<u>(76,175)</u>	<u>(110,896)</u>
Investing activities:		
Receipts of investment income – including realized gains and losses	3,076	2,534
Decrease (increase) in cash equivalents included in assets limited as to use or restricted	10,103	(8,216)
Purchases of investment securities	(611,576)	(471,974)
Proceeds from sale and maturities of investment securities	570,080	681,375
Net cash (used in) provided by investing activities	<u>(28,317)</u>	<u>203,719</u>
Net (decrease) increase in cash and cash equivalents	(13,397)	99,226
Cash and cash equivalents – beginning of year	<u>173,716</u>	<u>74,490</u>
Cash and cash equivalents – end of year	<u>\$ 160,319</u>	<u>173,716</u>

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

Statements of Cash Flows

Years ended February 28, 2015 and 2014

(In thousands)

	<b>2015</b>	<b>2014</b>
	<b>Harris Health System</b>	<b>Harris Health System</b>
Reconciliation of operating loss to net cash used in operating activities:		
Operating loss	\$ (653,467)	(627,464)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation and amortization	56,672	52,173
Changes in operating assets and liabilities:		
Decrease (increase) in accounts receivable	3,551	(21,037)
Increase in inventories	(2,256)	(1,618)
Decrease (increase) in Medicaid supplemental programs receivable	23,686	(50,529)
(Increase) decrease in prepaid expenses and other assets	(1,200)	1,823
Decrease in estimated third-party payor settlements	1,204	3,056
Decrease in net pension asset	51	53
(Decrease) increase in accounts payable and accrued liabilities	(10,321)	27,370
Increase (decrease) in employee compensation and related benefit liabilities	1,171	(15,463)
(Decrease) increase in compensated absences	(1,070)	309
Increase in estimated third-party payor settlements	6,112	1,304
Increase in postemployment health benefit liability	21,555	21,953
Total adjustments	99,155	19,394
Net cash used in operating activities	\$ (554,312)	(608,070)
Supplemental disclosures of noncash operating, financing, and investing activities:		
Unrealized gain on investments	\$ 1,426	511
Amounts related to acquisition of capital assets in accounts payable and accrued liabilities	7,022	18,414
Amount of interest expense capitalized	355	3,067

See accompanying notes to financial statements.

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

Notes to Financial Statements

February 28, 2015 and 2014

**(1) Organization and Mission**

Harris County Hospital District, dba Harris Health System, (the System), a component unit of Harris County, Texas, was created by authorization of the legislature of the State of Texas and subsequent approval by the voters of Harris County, Texas, in November 1965. The System provides patient care to the indigent population of Harris County and receives property taxes levied by Harris County for the provision of this care. The System operates two acute care hospitals and a hospital-based skilled nursing and rehabilitation facility and psychiatric unit, with a total of 963 licensed beds. The System also operates 18 primary care health clinics; 5 specialty clinics providing dental, dialysis, HIV/AIDS treatment and outpatient specialty services; 5 school-based clinics, 6 same day clinics, and 5 mobile health clinics. The System is exempt from federal income taxes.

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

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

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

Community Health Choice, Inc. (the HMO), is a Texas not-for-profit corporation incorporated on May 8, 1996, and organized under Section 501 (c)(4) of the Internal Revenue Code to operate as a health maintenance organization. The HMO was licensed by the Texas Department of Insurance on February 14, 1997. The HMO offers 3 Medicaid insurance products and had approximately 260,236 and 236,153 enrollees as of December 31, 2014 and 2013, respectively. In addition, starting in fiscal year 2014 the HMO now offers individual health insurance on the new Health Insurance Marketplace. The HMO is reported as a discretely presented component unit of the System since the HMO's Board of Directors is appointed by the System's Board of Managers and the System can impose its will on the HMO. The differences in amounts due to the System and due from the HMO in the accompanying statements of net position are primarily due

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

Notes to Financial Statements

February 28, 2015 and 2014

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

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

**(2) Summary of Significant Accounting Policies**

**(a) Basis of Accounting**

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

**(b) Method of Accounting**

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

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

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

- “Net investment in capital assets” consists of capital assets, net of accumulated depreciation, reduced by the amount outstanding for any bonds, notes, or other financing liabilities that were incurred related to the acquisition, construction, or improvement of the capital assets.
- “Restricted” consists of restricted assets reduced by liabilities and deferred inflows of resources related to the assets, and are primarily for debt service.
- “Unrestricted” is the net amount of the assets, deferred outflows of resources, liabilities, and deferred inflows of resources that are not included in the determination of net investment in capital assets or the restricted component of net position.

When an expense is incurred for purposes for which there are both restricted and unrestricted net assets 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.

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

Notes to Financial Statements

February 28, 2015 and 2014

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

**(c) Principles of Reporting**

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

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

The System provides certain administrative services to the HMO including employment of all individuals who perform the day-to-day requirements of the business functions of the HMO. The HMO reimburses the System for such salaries, wages, and benefits and these costs are reflected as expenses of the HMO. An additional fee for indirect costs approximating \$996,000 for fiscal years 2015 and 2014 is included as a revenue and expense in the System/HMO financial statements. As permitted and limited by the state of Texas laws applicable to insurance companies, the HMO's Board of Directors has approved certain agreements with the System and unrelated third parties whereby an allocation of surplus capital was committed to fund projects designed to further the HMO's mission of providing quality healthcare to the underserved population of Southeast Texas. Funds transferred to the System under these agreements are reflected as contributions (distributions) in the statements of revenues, expenses, and changes in net position.

The System supports the Foundation with payments for goods and services, approximately \$774,000 and \$781,000 in fiscal years 2015 and 2014, 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 \$1,342,000 and \$1,726,000 in 2015 and 2014, respectively. In addition, the Foundation distributed to the System contributions totaling \$542,000 and \$693,000 in 2015 and 2014, respectively, from its multi-year Capital Campaign funds.

**(d) Cash, Cash Equivalents, and Short-Term Investments**

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

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

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

Notes to Financial Statements

February 28, 2015 and 2014

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

**(e) *Foundation Net Position***

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

**(f) *Inventories***

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

**(g) *Capital Assets***

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

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

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

**(h) *Deferred Bond Issue Costs***

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

**(i) *Compensated Absences***

The System maintains a paid time-off plan. Under the paid time-off plan, the cost of all compensated absences is accrued at the time the benefits are earned. At the option of the employee, unused benefits may be liquidated at 50% or at the time of termination, unused benefits are payable at 75%. Changes

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

Notes to Financial Statements

February 28, 2015 and 2014

in the System's liability for compensated absences in fiscal years 2015 and 2014 are as follows (in thousands):

Fiscal year	Beginning- of-year liability	Current-year claims and changes in estimates	Claim payments	End-of-year liability
2015	\$ 41,047	58,850	59,920	39,977
2014	\$ 40,738	57,298	56,989	41,047

**(j) Classification of Revenues and Expenses**

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

**(k) Net Patient Service Revenue and Accounts Receivable**

Net patient service revenue is reported as the estimated net realized amounts from patients, third-party payors, and others for services rendered and includes estimated retroactive revenue adjustments under reimbursement agreements with third-party payors. In recognizing net patient service revenue, estimates are used in recording allowances for contractual adjustments and noncollectible accounts. Allowances for noncollectible accounts are estimated using historical experience, current trend information, aged account balances, and a collectibility analysis. The System's financial assistance program for uninsured patients classified as self-pay determines expected payments based on the Medicare allowable reimbursement. Charges in excess of the expected payment are reflected as an administrative uninsured discount. The allowance for uncollectible accounts was estimated at \$98,083,000 and \$78,219,000 as of February 28, 2015 and 2014, respectively. The System provides services under contract to patients covered under the Medicare and Medicaid programs. Net revenues from these programs are included in patient service revenue at estimated reimbursement based on customary billing charges, predetermined rates of reimbursement, plus certain adjustments. The amounts due to or from these programs are subject to final review and settlement by the program fiscal intermediary. Retroactive adjustments under third-party reimbursement agreements are considered in the recognition of revenue on an estimated basis in the period the related services are rendered, and such amounts are adjusted in future periods as adjustments become known. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, it is reasonably possible that these estimates could differ from actual settlements and thus change in the near term by material amounts. The System recognized a decrease in net patient service revenue of \$6.6 million during 2015 and an increase of \$4.7 million during 2014, respectively, from the differences between estimated and actual cost report settlements and appeals.



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

Notes to Financial Statements

February 28, 2015 and 2014

**(l) Charity Care Policy**

The System accepts all Harris County residents as patients regardless of their ability to pay. Harris County residents may qualify for partial financial assistance, on a sliding scale. The extent to which a resident will be financially responsible is determined based upon pre-established financial criteria, which utilize family income and size as it relates to the federal poverty guidelines set by the U.S. Department of Health and Human Services. Charity services are defined as those services for which no payment is anticipated. These amounts are not reported as revenue. The System maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges foregone for services and supplies furnished under the System's Financial Assistance program. The following information measures the level of charity care provided during the years ended February 28, 2015 and 2014.

	<b>2015</b>	<b>2014</b>
Charges foregone, based on established rates	\$ 1,523,549,000	1,577,870,000
Cost of foregone charges, estimated	591,972,000	631,621,000

**(m) Premium Revenue**

Premium revenue is recognized as revenue during the coverage period of the subscriber agreement. For its primary Medicaid business, the HMO is notified throughout the year of any new, removed, or revised members and the date of eligibility for coverage. The date of notification may be subsequent to the date of eligibility. The HMO believes that it has appropriately recognized premium revenue for the years ended December 31, 2014 and 2013.

**(n) Medical Claims Expense**

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

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

Contracts are evaluated to determine if it is probable that a loss will be incurred and a premium deficiency reserve is recognized when it is probable that expected future claims, including maintenance costs, will exceed existing reserves plus anticipated future premiums and reinsurance recoveries,

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

Notes to Financial Statements

February 28, 2015 and 2014

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, 2014, the HMO recognized a premium deficiency reserve in the amount of \$3,928,000 for the new Health Insurance Marketplace business. No premium deficiency reserve was recognized as of December 31, 2013.

Changes in the HMO's aggregate liability for medical claims and the premium deficiency reserve in fiscal years 2015 and 2014 are as follows (in thousands):

Fiscal year	Beginning of fiscal year liability	Medical claims and changes in estimates	Claim payments	Current-year premium deficiency reserve	End of fiscal year liability
2015	\$ 62,430	640,824	634,955	3,928	72,227
2014	\$ 72,203	615,143	624,916	—	62,430

In fiscal year 2015, the HMO paid \$571.6 million in claims related to the current fiscal year and \$63.3 million in claims related to the prior fiscal year. In fiscal year 2014, the HMO paid \$567.9 million in claims related to the current fiscal year and \$57.0 million in claims related to the prior fiscal year.

The HMO is a party to a reinsurance agreement to limit its losses on individual claims. Under the terms of the agreement, the reinsurer reimburses the HMO approximately 90%, subject to certain limitations as specified in the contract, of the cost of each member's annual inpatient hospital services. For the HMO's Medicaid and CHIP business, the HMO's recovery is based on costs in excess of a \$1,000,000 deductible, up to a limitation of \$1,000,000 per member per agreement period. The HMO also carries coverage for its Healthcare Insurance Marketplace (HIM) business for which the reinsurer reimburses the HMO approximately 90% of each member's annual inpatient hospital services in excess of a \$400,000 deductible, up to a limitation of \$1,000,000 per member per agreement period.

In addition, Section 1341 of the Affordable Care Act established a transitional reinsurance program to stabilize premiums in the individual market inside and outside of the marketplaces. The transitional reinsurance program will collect contributions from contributing entities to fund reinsurance payments to issuers of non-grandfathered reinsurance-eligible individual market plans, the administrative costs of operating the reinsurance program, and the General Fund of the U.S. Treasury for the 2014, 2015 and 2016 benefit years. Coverage is provided through the Center for Medicare & Medicaid Services (CMS) and will reimburse the HMO approximately 80% of the cost of each marketplace member's annual medical services for which cumulative paid claims are between \$25 and \$400 thousand dollars.

**(o) 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

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

Notes to Financial Statements

February 28, 2015 and 2014

Tax Assessor – Collector and are remitted to the System as received. On January 1, at the time of assessment, an enforceable lien is attached to the property for property taxes. Taxes are levied and become collectible from October 1 to January 31 of the succeeding year. Subsequent adjustments to the tax rolls, made by the County Assessor, are included in revenues in the period such adjustments are made by the County Assessor.

**(p) Tobacco Settlement Revenues**

In the fiscal years ended February 28, 2015 and 2014, the System received a portion of the funds from the settlement between various counties and hospital districts in Texas and the tobacco industry for tobacco-related healthcare costs. Under the program guidelines, the System is free to use the funds in either the immediate or future periods without restriction. The System recognizes all funds received from the settlement as nonoperating revenue in the period funds are received.

**(q) Use of Estimates**

The preparation of financial statements in conformity with U.S. generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates.

**(r) Newly Adopted Accounting Pronouncements**

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

**GASB Statement No. 70** – GASB Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*. The objective of the Statement is to improve accounting and financial reporting by state and local governments that extend and receive nonexchange financial guarantees. As a part of a nonexchange financial guarantee, a government commits to indemnify the holder of the obligation if the entity that issued the obligation does not fulfill its payment requirements. The Statement is effective for reporting periods beginning after June 15, 2013. The System has determined the Statement had no impact on its financial position, results of operations, and cash flow.

**Pending Adoption of Recent Account Pronouncements**

**GASB Statement No. 68** – The System has not completed the process of evaluating the impact that will result from implementing GASB Statement No. 68, *Accounting and Financial Reporting for Pensions, an amendment of GASB Statement No. 27*. The Statement objective is to improve accounting and financial reporting by pension plan sponsors. The Statement requires recognition of the entire net pension liability and a more comprehensive measure of pension expense and new footnote disclosures

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

Notes to Financial Statements

February 28, 2015 and 2014

and required supplementary information. The Statement is effective for financial statements prepared by state and local governments for periods beginning after June 15, 2014.

***GASB Statement No. 71*** – GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date, an amendment of GASB Statement No. 68*. The Statement is required to be applied simultaneously with the provisions of Statement No. 68, which is effective for financial statements for periods beginning after June 15, 2014.

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

**(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 28, 2010.

***Medicaid*** – Inpatient services rendered to Medicaid program beneficiaries are paid at prospectively determined rates per discharge similar to those of the Medicare inpatient program. Medicaid outpatient beneficiaries are reimbursed under a cost reimbursement methodology. For outpatients, the System is reimbursed a preliminary rate, with final settlement determined after submission of annual cost reports by the System and reviews thereof by the Medicaid administrative contractor based on Medicare administrative contractor audits. The System's Medicaid cost reports have been settled by the Medicaid administrative contractor through February 28, 2010.

Cash received from the Medicare program accounted for approximately 32% of the System's total cash collections for net patient service revenue for both years ended February 28, 2015 and 2014. Cash received from the Medicaid program (including managed Medicaid) accounted for approximately 49% and 51% of the System's total cash collections for net patient service revenue for the years ended February 28, 2015 and 2014.

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.

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

Notes to Financial Statements

February 28, 2015 and 2014

**(4) Medicaid Supplemental Programs**

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

The Upper Payment Limit (UPL) program was created in May 2002 with an effective date of July 2001. The UPL program used federal matching funds to raise state Medicaid reimbursement rates to 100% of equivalent Medicare rates for certain public hospital systems. In December 2011, Texas received federal approval to redirect the funding it would have received under the UPL program over the next five years into a new reform plan (1115 Waiver). The 1115 Waiver allows the state to expand Medicaid managed care, improve Medicaid services, and reward performance. Federal funding that would have been received by hospitals if managed care was not expanded is to be preserved. The upper payment limit program was replaced with two new pools of funding, the uncompensated care (UC) pool, and the delivery system reform incentive payment (DSRIP) pool. The UC pool directs more funding to hospitals that serve large numbers of uninsured patients and the DSRIP pool provides incentive payments for healthcare providers based on improvements in quality of care.

The System recognizes all funds received under the DSH and UC programs as operating revenues in the period applicable to the funds. Any amounts related to that year that are not received as of fiscal year-end are recorded as receivables and reflected in other current assets in the accompanying statements of net position. These receivables can be subject to adjustments that are reflected in the period they become known. The System recorded an unfavorable adjustment of \$0.3 million and \$1.1 million in fiscal year 2015 and 2014 for prior years programs, respectively. The System has recorded a receivable of \$219.9 and \$243.5 million at February 28, 2015 and 2014, respectively, related to the DSH and UC programs.

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

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

Notes to Financial Statements

February 28, 2015 and 2014

**(5) Assets Limited as to Use or Restricted**

Assets limited as to use or restricted represent those assets whose use has been legally restricted related to the 2007 and 2010 bond issues (50% of the greatest debt service requirement scheduled to occur); funds restricted by donors; or funds designated by the board for future debt service, future capital expansion, and other uses. Investments in government securities are recorded at fair value. The carrying amount of money market government funds approximates fair value. The fair values of securities are based on quoted market prices as of February 28, 2015 and 2014. The components of assets limited as to use or restricted at fair value at February 28, 2015 and 2014, are as follows (in thousands):

2015						
Description of assets	Total	Restricted debt service	Restricted/ designated capital expansion	Designated Legal reserves	Self-insured programs	Other
Money market government funds	\$ 247	—	—	—	—	247
Commercial paper	575	—	—	—	—	575
Government securities	30,750	30,750	—	—	—	—
	31,572	30,750	—	—	—	822
Less funds required for current liabilities	(6,041)	(6,041)	—	—	—	—
	\$ 25,531	24,709	—	—	—	822

  

2014						
Description of assets	Total	Restricted debt service	Restricted/ designated capital expansion	Designated Legal reserves	Self-insured programs	Other
Money market government funds	\$ 10,350	2,744	—	4,031	3,332	243
Commercial paper	255,773	4,994	52,312	—	197,891	576
Government securities	77,716	22,613	55,058	—	—	45
	343,839	30,351	107,370	4,031	201,223	864
Less funds required for current liabilities	(41,146)	(5,830)	(7,288)	(4,031)	(23,997)	—
	\$ 302,693	24,521	100,082	—	177,226	864

Foundation – Assets limited as to use of \$23.1 million and \$20.8 million at February 28, 2015 and 2014, respectively, are restricted subject to donor-imposed stipulations that will be met by actions of the Foundation or the passage of time.

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

Notes to Financial Statements

February 28, 2015 and 2014

**(6) Investment Risk**

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

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

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

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

Concentration of credit risk is the risk of loss attributed to the magnitude of an investment in a single issuer. The System mitigates these risks by emphasizing the importance of a diversified portfolio. All funds must be sufficiently diversified to eliminate the risk of loss resulting from overconcentration of assets in a specific maturity, a specific issuer, or a specific class of securities. In particular, no more than 50% of the overall portfolio may be invested in time deposits, including certificates of deposit, of a single issuer. Concentration by issuer for other investment instruments is not specifically addressed in the investment policy. However, the policy does specify that acceptable investment instruments must have high-quality credit ratings.

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

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

Notes to Financial Statements

February 28, 2015 and 2014

The table below indicates the fair value and maturity amount of the System's investments as of February 28, 2015 and 2014 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).

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



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

Notes to Financial Statements

February 28, 2015 and 2014

Security	2014				
	Fair value	Percentage of portfolio	Maturity amount	Modified duration (years)	Credit Rating S&P/ Rating Moody's
Commercial paper:					
GE Credit Corp.	\$ 59,907	10.62%	\$ 60,000	0.403	A-1+
TMCC	302,604	53.62	303,077	0.526	A-1+
Other:					
Cleveland City, OK ISD	3,708	0.66	3,630	2.005	AA+
King County Washington	10,603	1.88	10,000	14.767	AAA/Aa3
San Antonio Texas					
Electric and Gas	1,202	0.21	1,190	17.937	AA
Marion & Polk Ctys Ore School	1,283	0.23	1,280	1.293	Aa1
U.S. agency notes:					
FHLB	50,067	8.87	50,000	2.962	Aaa/AA+
FNMA	10,636	1.88	10,777	4.455	AAA/AA+
Money market mutual funds	124,294	22.03	124,294	0.003	AAA/Aaa
Total cash and investments	<u>\$ 564,304</u>	<u>100.00%</u>	<u>\$ 564,248</u>	<u>0.989</u>	

The System maintained no investments in derivatives at February 28, 2015 and 2014.

The table below indicates the fair value and maturity amount of the HMO's investments as of December 31, 2014 and 2013 summarized by security type. Also demonstrated are the percentage of total portfolio and the modified duration in years for each summarized security type (in thousands).

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

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

Notes to Financial Statements

February 28, 2015 and 2014

Security	2013				
	Fair value	Percentage of portfolio	Maturity amount	Modified duration (years)	Credit Rating S&P/ Rating Moody's
Commercial paper:					
TMCC/TMPR	\$ 104,454	69.50%	\$ 104,500	0.233	A-1+
U.S. agency notes:					
FNMA	29,342	19.52	30,000	4.085	AA+
Time deposit:					
JP Morgan Chase	3,323	2.21	3,323	0.400	AAA
Money market mutual funds	13,182	8.77	13,182	0.003	AAA
	<u>150,301</u>	<u>100.00%</u>	<u>151,005</u>	<u>0.982</u>	
Total cash and investments	\$ <u>150,301</u>	<u>100.00%</u>	\$ <u>151,005</u>	<u>0.982</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.

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, 2015 and 2014, the carrying amount of the HMO's demand and time deposits was \$6.6 million, respectively, as was the balance per various financial institutions. The System's deposits are not exposed to custodial credit risk since all deposits are either covered by FDIC insurance or collateralized with securities held by the System or its agent in the System's name, in accordance with the Public Funds Collateral Act.

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

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

Notes to Financial Statements

February 28, 2015 and 2014

According to the System's investment policy, no more than 25% of the portfolio, excluding those investments held for future capital expenditures, debt service payments, bond fund reserve accounts, and capitalized interest funds, may be invested beyond 24 months. Additionally, at least 15% of the portfolio, with the previous exceptions, is invested in overnight instruments or in marketable securities that can be sold to raise cash within one day's notice. Overall, the average maturity of the portfolio, with the previous exceptions, shall not exceed two years. As of February 28, 2015 and 2014, the System was in compliance with these guidelines.

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

**(7) Capital Assets**

The System's investment in capital assets as of February 28, 2015 and 2014, consists of the following (in thousands):

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

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

Notes to Financial Statements

February 28, 2015 and 2014

	<b>2014</b>			
	<b>Beginning balance</b>	<b>Additions/ transfers</b>	<b>Retirements</b>	<b>Ending balance</b>
Land and improvements	\$ 39,100	1,968	(9)	41,059
Buildings and fixed equipment	477,767	88,639	(217)	566,189
Major movable equipment	311,390	37,614	(14,200)	334,804
Total at historical cost	828,257	128,221	(14,426)	942,052
Less accumulated depreciation:				
Land and improvements	(7,163)	(1,088)	7	(8,244)
Buildings and fixed equipment	(250,298)	(17,362)	174	(267,486)
Major moveable equipment	(210,342)	(33,634)	12,706	(231,270)
Total accumulated depreciation	(467,803)	(52,084)	12,887	(507,000)
Construction in progress	64,930	(33,278)	—	31,652
Capital assets – net	\$ 425,384	42,859	(1,539)	466,704

Depreciation expense for the years ended February 28, 2015 and 2014 was \$56,584,000 and \$52,084,000, respectively.

**(8) Long-Term Debt**

**(a) Revenue Bonds**

On October 3, 2007, the System issued two Series of Harris County Hospital District Senior Lien Refunding Revenue Bonds (the Bonds). The Series 2007A Bonds, in the amount of \$199,085,000, were sold to provide funding for expansion and renovation projects, to refund the System's outstanding commercial paper, to cash fund the Debt Service Reserve Fund, and to pay costs of issuance. The Series 2007B Bonds, in the amount of \$103,525,000, were used to refund the Series 2000 revenue bonds and to pay costs of issuance.

The Series 2007A Bonds bear interest at an effective rate of approximately 5.1% (stated rates ranging from 5% to 5.25%) and were issued as fixed rate bonds with a final maturity on February 15, 2042. The Series 2007B Bonds have a final maturity date of February 1, 2042, and were initially issued as 28-day taxable auction-rate paper, convertible to tax exempt on August 16, 2010. In April 2008, these bonds were converted from auction-rate securities and reoffered as variable rate bonds bearing interest at a term rate during a term period. The 2007B Bonds Series were hedged with a forward starting swap effective upon the tax-exempt conversion of the bonds. The Series 2007 Bonds are insured by municipal bond insurance policies and secured by a lien on the pledged revenues of the System and certain funds established pursuant to the bond order.

In August 2010, the System refunded and refinanced the Series 2007B Bonds by issuing Series 2010 Refunding and Revenue bonds in the amount of \$104,435,000. The proceeds of the Series 2010 Bonds covered costs of issuance and defeased the Harris County Hospital District Senior Lien Refunding

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

Notes to Financial Statements

February 28, 2015 and 2014

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 \$21,531,000, which includes \$16,230,000 deferred loss on refunding related to the interest rate swap, which has been deferred and is being amortized over the life of the Series 2007B Bond issue. The remaining loss on refunding of \$5,301,000 has been deferred and is being amortized to interest expense over the life of the Series 2000 bond issue. The primary components of this loss were the write-offs of unamortized deferred financing costs and bond premiums, the net deferred amount related to the hedging derivative instrument associated with the 2007B Bonds and the difference between amounts funded for the defeasance and the principal due on the 2007B Bonds. The financial statements reflect deferred outflows-unamortized debt refunding loss of \$13,480,000 and \$15,224,000 at February 28, 2015 and 2014, respectively. Principal amounts of total defeased indebtedness outstanding at February 28, 2015 and 2014 are \$105,900,000 and \$127,950,000, respectively. The bonds are secured by an irrevocable letter of credit issued by JPMorgan Chase Bank.

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

Under an irrevocable letter of credit issued by JPMorgan Chase Bank, only the tender agent is entitled to draw an amount sufficient to pay the principal amount of the bonds when due, or to pay the portion of the purchase price corresponding to the principal amount upon certain tenders. The letter of credit facility's expiration date of August 12, 2014 has been amended and extended to August 12, 2016. Unreimbursed advances will accrue interest at the higher of (i) the Prime Rate, (ii) one-month LIBOR plus 2.5%, or (iii) 7.5% per annum. The System is also required to pay to the JPMorgan Chase Bank an annual facility fee for the letter of credit of 0.65% per annum of the outstanding principal amount of the bonds. No amounts were outstanding on the letter of credit as of February 28, 2015 and 2014. 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, 2015 and 2014.

**(b) Interest Rate Swap**

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

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

Notes to Financial Statements

February 28, 2015 and 2014

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

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

Swap terms:

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

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

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

**Fair Value** – The redesignated swap that is associated with the new debt had a zero fair value at its inception date and a fair value of (\$13.0) million and (\$0.3) million at February 28, 2015 and 2014, respectively, and is reported as a derivative liability in the balance sheet. The fair value of the swap was determined by calculating the present value of the anticipated future cash flows for both the floating portion and the stated fixed rate portion using discount factors derived from the London Interbank Offered Rate (LIBOR) swap curve.

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

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

**Collateral Posting Risk** – The risk that the System will be required to secure its obligations under the swap agreement. Any securities posted as collateral would not be available for the System’s expenditure or reserve needs, which could adversely impact credit ratings and overall liquidity and budgetary efforts. The System was not exposed to collateral posting risk as of and for the years ended February 28, 2015 and 2014.

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

Notes to Financial Statements

February 28, 2015 and 2014

**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, 2015 and 2014, the swap counterparty was rated A by Standard & Poor’s and A2 by Moody’s Investors Services. At February 28, 2015 and 2014, the System was rated A2 by Moody’s Investors Services and A by both Standard & Poor’s and Fitch.

**Rollover Risk** – The System is exposed to rollover risk only on swaps that mature or may be terminated at the counterparty’s option prior to the maturity of the associated debt. As of February 28, 2015 and 2014, the System was not exposed to rollover risk.

**Termination Risk** – The System’s swap agreements do not contain any out-of-the-ordinary termination events that would expose it to significant termination risk. In keeping with market standards, the System or the counterparty may terminate each swap if the other party fails to perform under the terms of the contract. In addition, the swap documents allow either party to terminate in the event of a significant loss of creditworthiness. If at the time of the termination a swap has a negative value, the System would be liable to the counterparty for a payment equal to the fair value of such swap. As of February 28, 2015 and 2014, termination of the original swap agreement would create a liability of \$28.5 million and \$15.5 million, respectively, and would result in a reversal of the derivative liability related to the redesignated swap, the borrowing payable amount, and the unamortized loss on refunding. Any resulting net change would be recorded through nonoperating expenses.

**Swap Payments** – Using interest rates as of February 28, 2015, debt service requirements of the System’s outstanding fixed and variable-rate debt and net swap payments on the variable-rate debt were as follows (in thousands). As rates vary, variable rate interest rate payments on the bonds and net swap payments will change.

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

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

Notes to Financial Statements

February 28, 2015 and 2014

Using interest rates as of February 28, 2014, 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.

	<u>Debt principal</u>	<u>Debt interest</u>	<u>Swaps, net</u>	<u>Total</u>
Year ending February:				
2015	\$ 5,195	13,846	(2,904)	16,137
2016	5,415	13,602	(2,847)	16,170
2017	5,635	13,347	(2,787)	16,195
2018	5,870	13,082	(2,726)	16,226
2019	6,130	12,805	(2,662)	16,273
2020–2024	35,135	59,422	(12,247)	82,310
2025–2029	44,280	50,241	(10,190)	84,331
2030–2034	55,945	38,490	(7,667)	86,768
2035–2039	70,830	23,462	(4,594)	89,698
2040–2042	51,420	5,166	(994)	55,592
Total	<u>\$ 285,855</u>	<u>243,463</u>	<u>(49,618)</u>	<u>479,700</u>

**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, 2015 and 2014 was as follows (in thousands):

	<u>2015</u>	<u>2014</u>
Beginning balance	\$ 14,417	15,280
Additions	—	—
Reductions	(846)	(863)
Ending balance	<u>\$ 13,571</u>	<u>14,417</u>



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

Notes to Financial Statements

February 28, 2015 and 2014

The following table sets forth as of February 28, 2015 and 2014, the amortization of the hybrid instrument borrowings for the next five years and thereafter (in thousands).

	<b>February 28, 2015</b>		<b>February 28, 2014</b>
Years ending February:		Years ending February:	
2016	\$ 828	2015	\$ 846
2017	811	2016	828
2018	792	2017	811
2019	773	2018	792
2020	754	2019	773
2021–2025	3,447	2020–2024	3,557
2026–2030	2,825	2025–2029	2,959
2031–2035	2,062	2030–2034	2,227
2036–2040	1,133	2035–2039	1,334
2041–2042	146	2040–2042	290
Total	\$ 13,571		\$ 14,417

**(c) Other Obligations**

Other long-term obligations at February 28, 2015 and 2014, are as follows (in thousands):

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

	<b>2014</b>		
	<b>Principal</b>	<b>Interest</b>	<b>Total</b>
Years ending February:			
2015	\$ 250	9	259
2016	157	5	162
2017	124	3	127
2018	109	1	110
2019	54	—	54
Total	\$ 694	18	712

**(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

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

Notes to Financial Statements

February 28, 2015 and 2014

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

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

**(a) Defined Contribution Plan**

The System has a defined contribution 401(k) plan (which qualifies as a tax-exempt employee benefit plan under Section 401(a) of the Internal Revenue Code) (401k Plan) open to all full-time and part-time employees of the System who meet the plan's requirements. It is a single-employer, self-administered, trustee plan to which contributions are made by participants on a biweekly basis not to exceed the statutory maximum of \$17,500 during calendar year 2014 and 2013 for all participants. Contributions to the plan cannot exceed the statutory maximum of \$23,000 during calendar year 2014 and 2013 for participants age 50 and older. Effective July 2007, the System enhanced the 401k Plan with an employer match up to 5% of the participant's compensation for eligible employees, which is 100% vested with three or more years of service. The 401k Plan is a governmental plan and, as such, is specifically exempt from the reporting and disclosure requirements of Title I of the Employee Retirement Income Security Act of 1974 (ERISA). Total participant contributions were \$25,022,814 and \$22,192,647 in fiscal years 2015 and 2014, respectively. Total System contributions were \$8,239,823 and \$7,041,561 in fiscal years 2015 and 2014, respectively.

**(b) 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 Managers of the System, which is responsible for administering the Plan under the terms that are established. The Board of Managers approves amendments to the Plan. State Street Bank & Trust Co. serves as the trustee and custodian for the Plan. As a unit of local government, the Plan is not covered by ERISA. The Plan is funded through actuarially determined contributions by the System. The projected unit credit method is used to determine both the funding and the pension benefit obligation.

Each participant shall have a monthly benefit payable for life equal to the greater of (a) the number of years of service multiplied by 1.5% of average monthly compensation (average base compensation received in five highest consecutive calendar years out of the ten complete calendar years prior to retirement) or (b) the accrued monthly retirement benefit determined as of January 1, 1989, plus the

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

Notes to Financial Statements

February 28, 2015 and 2014

number of years of future service earned after January 1, 1989, multiplied by 1.5% of average monthly compensation, subject to a minimum equal to the benefit earned under the Plan prior to the adoption of the 6th Amendment as of September 30, 1991 (applies to nonhighly compensated employees only). Monthly benefit payments are subject to a minimum based on the number of years of service multiplied by \$6 and a maximum provision permitted to be paid under Section 415 of the Internal Revenue Code. Participants may also elect to receive their benefits in other optional forms approved by the Administrative Committee.

*(c) Annual Pension Cost and Net Pension Asset*

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

<u>Fiscal year ended</u>	<u>Annual pension cost (APC)</u>	<u>Percentage of APC contributed</u>	<u>Net pension asset</u>
February 28, 2015	\$ 31,343,689	100%	\$ 2,179,741
February 28, 2014	34,011,966	100	2,231,266

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

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

During the year ended February 28, 2014, the System made cash contributions of \$33,959,223 to the pension trust. Pension expense recognized in the statements of revenues, expenses, and changes in net position was \$34,011,966.

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

Notes to Financial Statements

February 28, 2015 and 2014

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

	<u>2015</u>	<u>2014</u>
Annual required contribution	\$ 31,292,164	33,959,223
Interest discount on net pension asset	(167,345)	(171,301)
Adjustment to annual required contribution	<u>218,870</u>	<u>224,044</u>
Annual pension cost	31,343,689	34,011,966
Contributions made	<u>31,292,164</u>	<u>33,959,223</u>
Decrease in net pension asset	(51,525)	(52,743)
Net pension asset – beginning of year	<u>2,231,266</u>	<u>2,284,009</u>
Net pension asset – end of year	<u>\$ 2,179,741</u>	<u>2,231,266</u>

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

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

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

Actuarial cost method	Projected unit credit
Equivalent single amortization period	20 years
Asset valuation method	Five-year smoothed market
Actuarial assumptions:	
Inflation	3.0%
Investment rate of return (net of expenses)	7.5
Projected salary increases (ultimate rate)	4.0
Mortality rates:	
Healthy Pre-Commencement	RP2000 Combined Mortality Table with Improvement to 2050 under Scale AA
Healthy Post-Commencement	RP2000 Combined Mortality Table
Disabled	UP84, +4 Male and -1 Female rates, multiplied by 200%

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

Notes to Financial Statements

February 28, 2015 and 2014

**(d) *Deferred Compensation***

The System has a deferred compensation plan for the benefit of its eligible employees under Section 457 of the Internal Revenue Code of 1954. The assets in the Deferred Compensation Plan, which is not recorded in the accompanying balance sheet, are not subject to creditors. The Deferred Compensation Plan assets at February 28, 2015 and 2014 were approximately \$87,863,329 and \$85,173,121, respectively.

**(e) *Post Employment Benefits Other Than Pension***

In addition to providing pension benefits, the System provides certain healthcare benefits for retired employees. The System's employees may become eligible for those benefits upon completing 10 years of service. The number of retirees and beneficiaries eligible to receive the benefits was 2,621 and 2,470 at January 1, 2014 and 2013, respectively.

Retiree medical plan participants are provided benefits under the System's self insured medical plan. The contribution requirements of plan members and the System are established by and may be amended by the System's Board of Managers. For both fiscal years 2015 and 2014, the System contributed \$19 million to the Plan for current premiums and administrative costs. Plan members receiving benefits during both fiscal years 2015 and 2014 contributed \$3 million, or approximately 16% of the total premiums, through their required contribution of \$73.25 per month and \$62.42 per month, respectively, for retiree-only coverage and \$451.50 and \$383.42, respectively, for retiree and spouse coverage.

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

Notes to Financial Statements

February 28, 2015 and 2014

The System's annual OPEB cost or expense is calculated based on the annual required contribution of the System (ARC), an amount actuarially determined in accordance with GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions*. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities, or funding excess, over a period not to exceed 30 years. The following table shows the components of the System's annual OPEB cost for the years 2015 and 2014, the amount actually contributed to the Plan, and changes in the System's net OPEB obligation to the Plan (in thousands):

	<b>2015</b>	<b>2014</b>
Annual required contribution	\$ 37,703	38,589
Interest on net OPEB obligation	7,673	6,796
Adjustment to annual required contribution	(7,987)	(7,073)
Annual OPEB cost/expense	37,389	38,312
Contributions	15,834	16,359
Increase in net OPEB obligation	21,555	21,953
Net OPEB obligation – beginning of year	191,842	169,889
Net OPEB obligation – end of year	\$ 213,397	191,842

The System's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for 2015 and 2014 were as follows (in thousands):

		<b>2014</b>	
<b>Fiscal year</b>	<b>Annual OPEB cost</b>	<b>Percentage of OPEB contributed</b>	<b>Net OPEB obligation</b>
2015	\$ 37,389	42%	\$ 213,397
2014	38,312	43	191,842

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

As of the March 1, 2014 and 2013 actuarial valuations, the Plan was not prefunded. Contributions made were for current-year costs incurred only. The actuarially accrued liability for benefits was \$495.8 million and \$504.0 million for March 1, 2014 and 2013, respectively, and the actuarial value of assets was \$0 resulting in an unfunded actuarial accrued liability of \$495.8 million and \$504.0 million for March 1, 2014 and 2013, respectively. The covered payroll (annual payroll of active employees covered by the Plan) was \$210.7 million and \$220.4 million for March 1, 2014 and 2013, respectively. The ratio of the unfunded actuarial accrued liability to the covered payroll was 235.3% and 228.7% for March 1, 2014 and 2013, respectively.

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

Notes to Financial Statements

February 28, 2015 and 2014

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

In the March 1, 2014 and 2013 actuarial valuations, the projected unit credit actuarial cost method was used and the actuarial assumptions included a 4% investment rate of return. The 2014 actuarial valuation assumptions included an annual healthcare cost trend rate of 6.5% reduced by decrements to an ultimate rate of 4.75% after 5 years. The 2013 actuarial valuation assumptions included an annual healthcare cost trend rate of 7.0% reduced by decrements to an ultimate rate of 5.0% after 5 years. The initial unfunded actuarial liability was amortized over a period of 30 years based on a level percentage of payroll method.

**(10) Concentrations of Credit Risk**

The System provides services to its patients, most of whom are local residents and may be insured under third-party payor agreements, in accordance with its charity care policy (see note 2). Patient service revenues (see note 3) and the related accounts receivable are reflected in the 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, 2015 and 2014 is as follows:

	<b>2015</b>	<b>2014</b>
Medicaid	21%	19%
Medicare	28	27
Commercial	11	10
Self-pay patient	40	44
	100%	100%

**(11) Commitments and Contingencies**

At February 28, 2015 and 2014, the System was a defendant in certain pending civil litigation and has notice of certain claims that have been asserted against it. The System is covered under the Texas Tort Claims Act (the Claims Act). Under the Act, any claims and recoveries from pending or possible litigation due to personal injuries are limited to \$100,000 per person and \$300,000 per single occurrence of bodily injury or death. Professional liability claims have been asserted by various claimants. The claims are in various stages of processing, and some may ultimately be brought to trial. There are also other known and unknown incidents that have occurred through February 28, 2015, 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.

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

Notes to Financial Statements

February 28, 2015 and 2014

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, 2015 and 2014 are as follows (in thousands):

	<u>Beginning- of-year liability</u>	<u>Current-year claims and changes in estimates</u>	<u>Claim payments</u>	<u>End-of-year liability</u>
Hospital professional and general liability:				
2015	\$ 4,165	(2,243)	134	1,788
2014	2,581	1,786	202	4,165
Workers' compensation liability:				
2015	2,518	1,343	1,568	2,293
2014	2,438	1,667	1,587	2,518
Employee healthcare benefits liability:				
2015	9,382	85,813	85,855	9,340
2014	8,875	87,332	86,825	9,382

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

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

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

At February 28, 2014, the System had commitments outstanding in the amount of approximately \$7.2 million related to construction of new facilities, \$20.6 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 \$10,905,000 and \$8,415,000 during the years ended February 28, 2015 and 2014.



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

Notes to Financial Statements

February 28, 2015 and 2014

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

**(12) Harris Collaborative Program**

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

As part of the Harris collaboration, the Affiliated Hospitals formed a Certified Non-Profit Health Organization, Harris County Clinical Services Inc. (HCCS), to provide physician services to the indigent in the Harris County community. HCCS has an agreement with Affiliated Medical Services (AMS), a contracting entity for Baylor College of Medicine (Baylor) and the University of Texas Health Science Center (UT), which provides for Baylor and UT to supervise and direct services of patients of the System. With the creation of the collaborative, the agreement between AMS and HCCS was created in order to provide the physician services to indigent patients who seek treatment. In addition, HCCS also entered into agreements with other healthcare service providers to extend services available. Through its agreements with AMS and other providers, HCCS provides approximately \$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, 2015 and 2014, the System utilized \$196.3 million and \$158.2 million of tax revenues, respectively, as the nonfederal share of the Harris Collaborative program. The System recorded expenses of \$188.0 million and \$177.0 million in 2015 and 2014, respectively, under the Harris Collaborative program and provider affiliation agreements. These expenses are reflected as physician services in the statements of revenues, expenses, and changes in net position.

**(13) Subsequent Events**

The System evaluated subsequent events from February 28, 2015 through June 12, 2015, the date on which the financial statements were available to be issued. No events occurred that require consideration as adjustments to or disclosures in the financial statements.

**REQUIRED  
SUPPLEMENTARY INFORMATION**

**HARRIS COUNTY HOSPITAL DISTRICT,  
 dba HARRIS HEALTH SYSTEM,  
 A COMPONENT UNIT OF HARRIS COUNTY, TEXAS**  
 Schedule of Funding Progress of Defined Benefit Pension Plan  
 Three-Year Historical Trend Beginning January 1, 2012  
 (Unaudited)

Actuarial valuation date (1)	Actuarial value of assets (AVA) (2)	Actuarial accrued liability (AAL) (3)	Unfunded actuarial accrued liability (UAAL) (3) – (2) (4)	Funded ratio (2)/(3) (5)	Annual covered payroll (6)	UAAL as a percentage of covered payroll (4)/(6)
January 1, 2012	\$ 450,121	576,557	126,436	78.1	229,056	55.2
January 1, 2013	456,765	639,144	182,379	71.5	220,398	82.7
January 1, 2014	499,862	657,817	157,955	76.0	210,728	75.0

Dollar amounts in thousands.

See accompanying independent auditors' report.

**HARRIS COUNTY HOSPITAL DISTRICT,  
 dba HARRIS HEALTH SYSTEM,  
 A COMPONENT UNIT OF HARRIS COUNTY, TEXAS**  
 Schedule of Actuarial Data for Defined Benefit Pension Plan  
 January 1, 2014  
 (Unaudited)

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

Valuation date	January 1, 2014
Actuarial cost method	Projected unit credit
Amortization method	Level dollar, open
Amortization period	20 years
Asset valuation method	Five-year smoothed market
Actuarial assumptions:	
Inflation	3.0%
Investment rate of return	7.5%
Projected salary increases (ultimate rate)	4.0%
Cost-of-living adjustments	Not applicable
Mortality rates:	
Healthy Pre-Commencement	RP2000 Combined Mortality Table with Improvement to 2050 under Scale AA
Healthy Post-Commencement	RP 2000 Combined Mortality Table
Disabled	UP84, +4 Male and -1 Female rates, multiplied by 200%

See accompanying independent auditors' report.

**HARRIS COUNTY HOSPITAL DISTRICT,  
 dba HARRIS HEALTH SYSTEM,  
 A COMPONENT UNIT OF HARRIS COUNTY, TEXAS**  
 Schedule of Funding Progress of Other Postemployment Benefit Plan  
 Three-Year Historical Trend Beginning March 1, 2012  
 (Unaudited)

Actuarial valuation date (1)	Actuarial value of assets (AVA) (2)	Actuarial accrued liability (AAL) (3)	Unfunded actuarial accrued liability (UAAL) (3) – (2) (4)	Funded ratio (2)/(3) (5)	Annual covered payroll (6)	UAAL as a percentage of covered payroll (4)/(6)
March 1, 2012	\$ —	566,614	566,614	—	229,056	247.4
March 1, 2013	—	504,029	504,029	—	220,398	228.7
March 1, 2014	—	495,780	495,780	—	210,728	235.3

Dollar amounts in thousands.

See accompanying independent auditors' report.