

**TRAVIS COUNTY
HOSPITAL DISTRICT,
A COMPONENT UNIT OF
TRAVIS COUNTY, TEXAS**

**Financial Statements for the
Year Ended September 30, 2005 and
Independent Auditors' Report**



**TRAVIS COUNTY HOSPITAL DISTRICT,
A COMPONENT UNIT OF TRAVIS COUNTY, TEXAS**

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**TRAVIS COUNTY HOSPITAL DISTRICT,
A COMPONENT UNIT OF TRAVIS COUNTY, TEXAS**

YEAR ENDED SEPTEMBER 31, 2005

MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of the Travis County Hospital District's (the "District") financial report presents background information and management's analysis of the District's financial results for the fiscal year ended September 30, 2005, the District's initial year of operation. Please read this section in conjunction with the District's financial statements, which begin on page 10.

Background and Formation

In 2003, the 78th Session of the Texas Legislature amended Chapter 281 of the Texas Health and Safety Code to enable Travis County, Texas ("Travis County") to create a hospital district. For a copy of the code see: <http://www.capitol.state.tx.us/statutes/hs.toc.htm>.

Chapter 281 states that a county may create a countywide hospital district to furnish medical aid and hospital care to indigent and needy persons residing in the district. The law stipulates that creation of the district is dependent upon approval by a majority of the qualified voters of the county. On May 15, 2004, Travis County held a countywide election to determine if the voters of the county supported the creation of a hospital district. The proposition passed with 54.73% of the voters (31,920 votes) supporting the creation of the District.

The formation of the District was in large part due to a collaborative campaign that focused on educating the voters about the healthcare issues facing the community. This campaign was led by a steering committee that included: physicians, healthcare advocates, business community, elected officials, Grey Panthers and the Indigent Care Collaboration, among others.

The District may levy taxes to finance health care services and the levy may not exceed 25 cents on each \$100 of the taxable value of property taxable by the District. The current tax levy for the District is .0779 per \$100 valuation.

The law allows the District to create a health maintenance organization to provide or arrange for health care services. Additionally, the District may create a charitable organization to develop resources for the District or providing ancillary support. Under state law counties are required to provide medical services for indigent residents. In Texas, indigent is defined as an individual with net income at or below 21% of federal poverty income guideline (Chapter 61 of the Texas Health and Safety Code).

Upon creation of the District, Travis County and the City of Austin, Texas ("City of Austin") transferred the portion of their tax bases dedicated to healthcare, to the District. This change served to redistribute the cost of healthcare more equally across all residents of Travis County. Previously, City of Austin residents paid a higher percentage of their taxes for healthcare than did those residing within Travis County but outside the City of Austin's city limits. With the creation of the District, the tax burden was distributed equally across all residents. In addition to the tax base, the District received ownership of and responsibility for Brackenridge/Children's Hospital (leased to Seton Healthcare Network to operate), Austin Women's Hospital (leased to the University of Texas Medical Branch to operate) and the Austin/Travis County Community Health Centers (operated by the City of Austin).

Financial Highlights

This is the initial year of operation for the District and therefore there is no comparison to the prior year.

- The District's net assets increased \$131.0 million of which \$112.2 million is related to assets conveyed or donated to the District.
- During the year, the District's net operating revenue was \$29.2 million and operating expenses were \$58.5 million. Nonoperating revenue, comprised primarily of property tax, was \$48.2 million.

To promote fiscal responsibility, the District made the decision to maintain reserve funds to protect its financial security and operational stability in consideration of the risks it faces. Initially, a reserve policy was established that the District would build and maintain an unallocated reserve at a minimum of 11% of budgeted operational expenses. This reserve was met for this fiscal year. The District's reserve policy will be reviewed annually in association with the budget process.

Financial Statements

The District's financial statements are prepared on the accrual basis of accounting and present the District's operational activities in a manner similar to that of private sector companies. The financial statements consist of three statements: (1) statement of net assets, (2) statement of revenue, expenses, and changes in net assets, and (3) statement of cash flows.

The statement of net assets and the statement of revenue, expenses, and changes in net assets reflect the District's financial position at the end of the year and report the District's net assets and changes in them as a result of the District's revenues and expenses for the year. The term "net assets" represents the difference between assets, or the District's investment in resources, and liabilities, or the District's obligation to its creditors. Increases or decreases in net assets 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 District'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 financing activities. The statement explains where cash came from, how it was used, and the change in cash balance during the year.

Statement of Net Assets

The following table summarizes the District's assets, liabilities and net assets as of September 30, 2005 and does not include a year to year comparison as this was the first year of operation:

TABLE 1
Condensed Statement of Net Assets

	<u>2005</u>
Current and other assets	\$ 45,701,566
Capital assets	<u>97,010,002</u>
Total assets	<u>142,711,568</u>
Current liabilities	<u>11,720,415</u>
Invested in capital assets	97,010,002
Unrestricted	<u>33,981,151</u>
Total net assets	<u>\$ 130,991,153</u>

As can be seen in Table 1, net assets were \$131.0 million at September 30, 2005. The change in net assets is primarily the result of donated assets of \$98.9 million, contributions of \$13.3 million, and operations of \$18.8 million.

Statement of Revenues, Expenses, and Changes in Net Assets

The following table summarizes the District's revenues and expenses and changes in net assets during the year ended September 30, 2005 and does not include a year to year comparison as this was the first year of operation:

TABLE 2
Condensed Statement of Revenues, Expenses, and Changes in Net Assets

	2005
Operating revenues:	
DSH/UPL program	\$ 28,029,577
Operating lease revenue	1,155,396
Total operating revenues	29,184,973
Operating expenses:	
Health care delivery	56,036,996
Salaries and benefits	160,410
Other purchased goods and services	423,808
Depreciation	1,892,495
Total operating expenses	58,513,709
Operating loss	(29,328,736)
Nonoperating revenues (expenses):	
Net ad valorem tax revenue	46,299,165
Net tobacco settlement revenue	1,165,771
Investment income	690,752
Total nonoperating revenues	48,155,688
Income before other changes in net assets	18,826,952
Contributions	112,164,201
Change in net assets	130,991,153
Total net assets – beginning of year	-
Total net assets – end of year	\$ 130,991,153

The District's operating revenue was \$29.2 million, comprised of \$28.0 million in Disproportionate Share III ("DSH") and Upper Payment Limit ("UPL") revenue and \$1.2 million in rent revenue relating to Brackenridge/Children's Hospital and Austin Women's Hospital. UPL receipts were higher than initially projected as additional funds were received relating to a prior year.

The District's operating loss was \$29.3 million. The District 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 levied to subsidize those costs are required to be reported as nonoperating revenues.

Nonoperating revenues were \$48.2 million, comprised of net property taxes of \$46.3 million, net tobacco settlement revenue of \$1.2 million and investment income of \$0.7 million. In addition, the District received conveyed and donated assets and cash contributions from the City of Austin and Travis County of \$112.2 million. The resulting change in net assets for the year ended September 30, 2005 is \$131.0 million.

Capital Assets

With the creation of the District, the City of Austin conveyed ownership of assets associated with Brackenridge/Children's Hospital, the Austin Women's Hospital, and medical equipment used in the health care clinics to the District. Travis County conveyed medical equipment used in the health care clinics to the District. The City of Austin donated an office building to the District which the District uses for its headquarters. The conveyed and donated assets were recorded at fair market value at the date of receipt based on an independent third-party appraisal.

TABLE 3
Capital Assets

	<u>2005</u>
Land and improvements	\$ 8,497,335
Buildings and improvements	90,002,665
Equipment and furniture	<u>402,497</u>
Subtotal	<u>98,902,497</u>
Less accumulated depreciation	<u>(1,892,495)</u>
Net property, plant, and equipment	<u>\$ 97,010,002</u>

The District's budget for fiscal year 2005 included funds for equipment replacement in the Austin/Travis County Community Health Centers as a part of the interlocal agreement with the City of Austin to operate the clinics. These funds are budgeted as an operating expense and ownership of the assets will not convey to the District until the termination of the interlocal agreement.

Current Budget

Annually, the District prepares a budget for approval by the Board of Managers and for submission to the Travis County Commissioners' Court for approval prior to the beginning of the operating year. Table 4 presents the budget as compared to fiscal year 2005 actual amounts.

TABLE 4
Budget vs. Actual

	Budget 2005	Actual 2005	Favorable (Unfavorable) Variance
Operating revenues:			
DSH/UPL program	\$ 15,470,760	28,029,577	12,588,817
Operating lease revenue	1,155,396	1,155,396	-
Total operating revenues	<u>16,626,156</u>	<u>29,184,973</u>	<u>12,558,817</u>
Other expenses:			
Health care delivery	62,296,818	56,036,996	6,259,822
Salaries and benefits	406,882	160,410	246,472
Other purchased goods and services	792,000	423,808	368,192
Depreciation	192,000	1,892,495	(1,700,495)
Total operating expenses	<u>63,687,700</u>	<u>58,513,709</u>	<u>5,173,991</u>
Operating loss	<u>(47,061,544)</u>	<u>(29,328,736)</u>	<u>17,732,808</u>
Nonoperating revenues (expenses):			
Net ad valorem tax revenue	46,890,808	46,816,179	74,629
Tax assessment and collection expense	(576,493)	(517,014)	59,479
Tobacco settlement revenue	672,141	1,471,021	798,880
Tobacco settlement expense	-	(305,250)	(305,250)
Investment income	325,000	690,752	365,752
Total nonoperating revenues	<u>47,311,456</u>	<u>48,155,688</u>	<u>844,232</u>
Income before other changes in net assets	<u>249,912</u>	<u>18,826,952</u>	<u>18,577,040</u>
Contributions:			
Contributions from the City of Austin	10,700,000	109,602,497	98,902,497
Contributions from Travis County	1,728,231	2,560,807	832,576
Other contributions	-	897	897
Total contributions	<u>12,428,231</u>	<u>112,164,201</u>	<u>99,735,970</u>
Change in net assets	<u>\$ 12,678,143</u>	<u>130,991,153</u>	<u>118,313,010</u>

In comparing the current year's financial results to budget, the following items are noted.

Upon completion of the year, operating revenues exceeded budget by \$12.6 million and this increase is due to monies received related to the DSH and UPL programs.

Actual operating expenses were under budget by \$5.2 million primarily related to health care delivery costs associated with the operation of the community health care clinics and contractual arrangements with Seton related to the operation of Brackenridge Hospital. The District was able to achieve income \$18.6 million greater than planned.

With the creation of the District, the City of Austin conveyed ownership of assets associated with Brackenridge/Children's Hospital, the Austin Women's Hospital, and medical equipment used in the health clinics to the District. Travis County conveyed medical equipment used in the community health clinics to the District. The City of Austin also donated an office building to the District which the District uses for its headquarters. These conveyed and donated assets were recorded at fair market value based on an appraisal and represent the increase in contributions greater than the budgeted amounts by \$99.7 million.

Economic Conditions and Plan for Fiscal Year 2006

In planning for fiscal year 2006, of primary concern was the uncertain status of the economy at both the federal and state funding levels. Issues that need to be addressed on an ongoing basis throughout the year include the following:

- Development of a strategic plan for the District.
- An increasing number of uninsured and working poor, and the capacity of the District's system at both a physical plant capacity level and staffing availability level to serve this growing population.
- Reduction in Medicaid funds.
- Future funding available under the DSH and UPL programs.

The tax rate for fiscal year 2006 remains unchanged from fiscal year 2005 at .0779 per \$100 valuation.

Contacting District Financial Management

The financial report is designed to provide the taxpayers and the District's customers, creditors, and suppliers with a general overview of the District's finances and to demonstrate the District's accountability for the funds it receives. If you have questions about this report or need additional financial information, contact the District's financial offices as follows:

By mail: Travis County Hospital District, 1111 E. Cesar Chavez, Austin, Texas 78702
Attention: Financial Manager

By fax: 512.972.5506, Travis County Hospital District, Attention: Financial Manager



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INDEPENDENT AUDITORS' REPORT

The Board of Managers of
Travis County Hospital District:

We have audited the accompanying statement of net assets of Travis County Hospital District (the "District"), a component unit of Travis County, Texas as of September 30, 2005, and the related statements of revenues, expenses, and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the District, as of September 30, 2005, and the respective changes in financial position and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 18, 2005, on our consideration of the District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in conjunction with this report in considering the results of our audit.

Affiliated Companies
ML&R PERSONNEL SOLUTIONS LLC
"The Resource for Direct Hire & Project Staffing"
ML&R WEALTH MANAGEMENT LLC*

*A Registered Investment Advisor
*This firm is not a CPA firm

The management's discussion and analysis on pages 1 through 7, is not a required part of the financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Maxwell Locke + Ritter LLP

November 18, 2005

**TRAVIS COUNTY HOSPITAL DISTRICT,
A COMPONENT UNIT OF TRAVIS COUNTY, TEXAS**

**STATEMENT OF NET ASSETS
SEPTEMBER 30, 2005**

ASSETS

Current assets:

Cash and cash equivalents	\$ 38,332
Short-term investments	42,447,382
Ad valorem taxes receivable, net of allowance for uncollectible taxes of \$50,435	163,408
Due from other governments	2,876,671
Other receivables	174,288
Prepaid expenses and other current assets	1,485
Total current assets	<u>45,701,566</u>

Property, plant, and equipment:

Land and improvements	8,497,335
Buildings and improvements	90,002,665
Equipment and furniture	402,497
Less accumulated depreciation	(1,892,495)
Total property, plant, and equipment, net	<u>97,010,002</u>

Total assets	<u>142,711,568</u>
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LIABILITIES

Current liabilities:

Accounts payable	11,667,695
Salaries and benefits payable	23,532
Due to other governments	29,188
Total current liabilities	<u>11,720,415</u>

NET ASSETS

Invested in capital assets	97,010,002
Unrestricted	33,981,151
Total net assets	<u>\$ 130,991,153</u>

The notes to the financial statements are an integral part of this statement.

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

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
YEAR ENDED SEPTEMBER 30, 2005

Operating revenues:	
DSH/UPL program	\$ 28,029,577
Operating lease revenue	1,155,396
Total operating revenues	<u>29,184,973</u>
Operating expenses:	
Health care delivery	56,036,996
Salaries and benefits	160,410
Other purchased goods and services	423,808
Depreciation	1,892,495
Total operating expenses	<u>58,513,709</u>
Operating loss	<u>(29,328,736)</u>
Nonoperating revenues (expenses):	
Ad valorem tax revenue	46,816,179
Tax assessment and collection expense	(517,014)
Tobacco settlement revenue	1,471,021
Tobacco settlement expense	(305,250)
Investment income	690,752
Total nonoperating revenues	<u>48,155,688</u>
Income before other changes in net assets	<u>18,826,952</u>
Contributions:	
Contributions from the City of Austin, Texas	109,602,497
Contributions from Travis County, Texas	2,560,807
Other contributions	897
Total contributions	<u>112,164,201</u>
Change in net assets	130,991,153
Total net assets - beginning of year	<u>-</u>
Total net assets - end of year	<u>\$ 130,991,153</u>

The notes to the financial statements are an integral part of this statement.

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

STATEMENT OF CASH FLOWS
YEAR ENDED SEPTEMBER 30, 2005

Cash flows from operating activities:	
Cash received from DSH/UPL program	\$ 85,482,921
Cash payments for DSH/UPL program	(48,350,829)
Cash received from operating leases	1,150,501
Cash payments for goods and services	(56,913,985)
Cash payments to employees	(136,878)
Net cash used in operating activities	<u>(18,768,270)</u>
Cash flows from noncapital financing activities:	
Ad valorem taxes received	46,652,771
Payments for tax assessment and collection	(517,014)
Tobacco settlement received	1,471,021
Tobacco settlement paid	(305,250)
Net cash provided by noncapital financing activities	<u>47,301,528</u>
Cash flows from capital and related financing activities -	
Contributions	13,261,704
Net cash provided by capital and related financing activities	<u>13,261,704</u>
Cash flows from investing activities:	
Receipts of interest income	631,568
Purchase of investment securities	(47,380,500)
Proceeds from sale and maturities of investment securities	4,992,302
Net cash used in investing activities	<u>(41,756,630)</u>
Net increase in cash and cash equivalents	38,332
Cash and cash equivalents at beginning of year	-
Cash and cash equivalents at end of year	<u>\$ 38,332</u>
Reconciliation of operating loss to net cash used in operating activities:	
Operating loss	\$ (29,328,736)
Adjustments to reconcile operating loss to net cash used in operating activities:	
Depreciation expense	1,892,495
Changes in operating assets and liabilities:	
Increase in due from other governments	(2,876,671)
Increase in other receivables	(174,288)
Increase in prepaid expenses and other assets	(1,485)
Increase in accounts payable	11,667,695
Increase in salaries and benefits payable	23,532
Increase in due to other governments	29,188
Net cash used in operating activities	<u>\$ (18,768,270)</u>
Schedule of noncash capital and related financing activities -	
Donated assets	\$ 98,902,497

The notes to the financial statements are an integral part of this statement.

**TRAVIS COUNTY HOSPITAL DISTRICT,
A COMPONENT UNIT OF TRAVIS COUNTY, TEXAS**

**NOTES TO FINANCIAL STATEMENTS
YEAR ENDED SEPTEMBER 30, 2005**

1. ORGANIZATION AND MISSION

Travis County Hospital District (the "District"), a component unit of Travis County, Texas ("Travis County"), was created by authorization of the legislature of the State of Texas and subsequent approval by the voters of Travis County, Texas, in May 2004. In August 2004, Travis County and the City of Austin, Texas (the "City of Austin") appointed members to serve on the Board of Managers (the "Board") of the District, which is comprised of nine members. The Board consists of four appointees from Travis County, four from the City of Austin, and one selected jointly.

The District is presented as a discrete component unit of Travis County (legally separate from Travis County), as the Travis County Commissioners' Court approves the District's tax rate and annual budget. Additionally, the Travis County Commissioners' Court appoints four and one jointly appointed members of the District's governing board. Travis County does not provide any funding to the District, hold title to any of the District's assets, or have any rights to any surpluses of the District.

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

On October 1, 2004, the District began operations with the transfer of \$10,700,000 from the City of Austin. Thereafter, \$2,560,807 was transferred from Travis County. Effective October 1, 2004, certain assets, obligations and rights of the City of Austin transferred to the District, including title to the land and buildings of Brackenridge/Children's Hospital and Austin Women's Hospital. In addition, the responsibility, obligations and rights of the City of Austin and Travis County to provide health care to their respective indigent population transferred to the District. Certain assets associated with the Federally Qualified Health Centers ("health clinics") of the City of Austin and Travis County also transferred to the District.

The District provides patient care to the indigent population of Travis County and receives property taxes levied by Travis County for the provision of this care. The District has contracted with third-parties to operate the District's two acute care hospitals with a total of 399 licensed beds. Through an interlocal agreement with the City of Austin, the District also operates thirteen health clinics (which includes one specialty clinic providing HIV/AIDS treatment services and two clinics that provide services to the homeless populations), three dental clinics, and one mobile dental clinic. The District is exempt from federal income taxes.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

Method of Accounting - The District's accounting policy is to apply all Financial Accounting Standards Board ("FASB") Statements and Interpretations issued after November 30, 1989, except for those that would conflict with or contradict Governmental Accounting Standards Board ("GASB") pronouncements.

In accordance with GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis -for State and Local Governments*, the District's financial statements include a statement of net assets, a statement of revenues, expenses, and changes in net assets, and a statement of cash flows.

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

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

Cash and Cash Equivalents - The District defines cash and cash equivalents as cash and investments that are highly liquid with less than three-month maturities when purchased.

Property, Plant, and Equipment - Property, plant, and equipment are carried at historical cost if purchased or fair market value at the time of donation. The District includes expenditures for new facilities and equipment and expenditures that substantially increase the useful life of existing property, plant, and equipment which have an initial, individual cost of \$5,000 or more. Ordinary maintenance and repairs are charged to expense when incurred. Disposals are removed at carrying cost less accumulated depreciation, with any resulting gain or loss included in other nonoperating revenue or expense.

Depreciation is recorded on the straight-line method over the estimated useful lives of the assets. Estimated useful lives for buildings are up to 50 years and for equipment are 2 to 20 years.

Compensated Absences - The District maintains a vacation and sick-leave plan. Under the plan, the cost of all compensated absences is accrued at the time the benefits are earned. At the time of termination, unused vacation benefits may be paid up to a maximum of 1.5 times the annual accrual.

Statements of Revenues, Expenses, and Changes in Net Assets - For purposes of display, transactions deemed by management to be ongoing, major, or central to the provision of health care services are reported as 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.

Ad Valorem Tax Revenue - Ad valorem tax revenue is recorded in the year for which the taxes are levied, net of provisions for uncollectible amounts, collection expenses, and appraisal fees. The District levies a tax as provided under state law with the approval of Travis County Commissioners' Court. The taxes are collected by the Travis County Tax Assessor-Collector and are remitted to the District as received. 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 Travis Central Appraisal District ("Appraisal District"), are included in revenues in the period such adjustments are made by the Appraisal District.

Tobacco Settlement Revenue - Tobacco settlement revenue is the result of a settlement between various counties and hospital districts in Texas and the tobacco industry for tobacco-related health care cost. The District recognized \$1,471,021 associated with the settlement in fiscal year 2005. Settlement revenues for fiscal year 2006 and beyond will be based on the investment earnings of the tobacco settlement fund as administered by the Comptroller's Office of the State of Texas. The District is unable to estimate the continuance or level of future distributions. The District paid \$262,624 of the tobacco settlement revenue to the Daughters of Charity Health Services of Austin ("Seton") and \$42,625 to Travis County which represents their respective share of healthcare expenditures claimed.

Use of Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States 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.

3. DEPOSITS AND INVESTMENTS

At September 30, 2005, the carrying amount of the District's deposits was \$38,332 and the bank balance was \$29,939.

The District's deposits with financial institutions at September 30, 2005 and during the year ended September 30, 2005 were entirely covered by Federal Deposit Insurance Corporation ("FDIC") insurance or by pledged collateral held by the District's agent bank in the District's name, with the exception of one instance of under collateralization in January 2005. The deposits were collateralized in accordance with Texas law.

Chapter 2256 of the *Texas Government Code* ("the Public Funds Investment Act") authorizes the District to invest in funds under a written investment policy. The District's deposits and investments are invested pursuant to the investment policy, which is approved annually by the Board of Managers. The primary objectives of the District's investment strategy, in order of priority, are safety of principal, maintenance of adequate liquidity and return on investments.

During the initial year of operation, the District is authorized to invest in the following investment instruments provided that they meet the guidelines established in the investment policy:

- Obligations of the United States of America.
- Certificates of deposit issued by a state or national bank domiciled in Texas or a savings bank domiciled in Texas, or a state or federal credit union domiciled in Texas that are guaranteed or insured by the FDIC or secured by certain obligations that have a market value of not less than the principal amount of the certificates.
- Public funds and local government investment pools under certain conditions.
- Domestic commercial paper with a stated maturity of 270 days or less from the date of its issuance that is rated not lower than A-1 by Standard and Poor's and P-1 by Moody's if it is purchased indirectly through a local government investment pool.

In subsequent years of operation, the District is authorized to invest in the following investment instruments provided that they meet the guidelines established in the investment policy:

- Obligations of the United States of America or its agencies and instrumentalities.
- Direct obligations of the State of Texas or its agencies and instrumentalities.
- Other obligations, the principal and interest on which are unconditionally guaranteed or insured or backed by the full faith and credit of the State of Texas or the United States of America or its agencies or instrumentalities.
- Obligations of states, agencies, counties, cities and other political subdivision of any state that have received a rating of investment quality of not less than AA by Moody's or Standard and Poor's.
- Domestic commercial paper with a stated maturity of 270 days or less from the date of its issuance that is rated not lower than A-1 by Standard and Poor's and P-1 by Moody's.
- Fully collateralized repurchase agreements including direct security repurchase agreements and reverse security agreements that meet certain requirements defined in the District's investment policy.
- Certificates of deposit issued by a state or national bank domiciled in Texas or a savings bank domiciled in Texas, or a state or federal credit union domiciled in Texas that are guaranteed or insured by the FDIC or secured by certain obligations that have a market value of not less than the principal amount of the certificates.
- No-load money market mutual funds that are registered with the Securities and Exchange Commission and meet certain requirements defined in the District's investment policy.
- Public funds and local government investment pools under certain conditions.

The District participates in the Texas Local Government Investment Pool ("TexPool") and the TexasTERM Local Government Investment Pool ("TexasTERM") which are external investment pools offered to local governments. TexPool and TexasTERM are not SEC registered, however, they are regulated by the State Comptroller of Public Accounts. These investments are stated at fair value which is the same as the value of the pool shares.

Investments held at September 30, 2005 consisted of the following:

Type	Fair Value	Weighted Average Maturity (Days)	Standard & Poor's Rating
TexPool	\$ 27,725,879	1	AAAm
TexPool Prime	4,850,989	1	AAAm
TexasTERM/TexasDAILY	<u>9,870,514</u>	1	AAAm
Total investments	<u>\$ 42,447,382</u>		

Credit Risk - At September 30, 2005, investments were included in local government investment pools in compliance with the District's investment policy.

Interest Rate Risk - As a means of minimizing risk of loss due to interest rate fluctuations, the investment policy requires that maturities for investments shall not exceed the dollar weighted average maturity of 180 days during the initial year of operation and 365 days during the subsequent years. The District considers the holdings in the local government investment pools to have a one day weighted average maturity due to the fact that the share position can usually be redeemed each day at the discretion of the shareholder, unless there has been a significant change in value.

4. DISAGGREGATION OF RECEIVABLE BALANCES

The District's receivables, including the applicable allowances, are comprised of the following as of September 30, 2005:

	Taxes	Due from Other Governments	Other	Total
Total	\$ 504,347	2,876,671	174,288	3,555,306
Less:				
Allowance for uncollectibles	(50,435)	-	-	(50,435)
Allowance for long-term collections	<u>(290,504)</u>	-	-	<u>(290,504)</u>
Total, net	<u>\$ 163,408</u>	<u>2,876,671</u>	<u>174,288</u>	<u>3,214,367</u>
Amounts not scheduled for collection during the subsequent year	<u>\$ 220,129</u>	<u>-</u>	<u>-</u>	<u>220,129</u>

5. PROPERTY, PLANT, AND EQUIPMENT

The District's property, plant, and equipment is comprised of the following as of September 30, 2005:

	Beginning Balance	Increases	Decreases	Ending Balance
Land and improvements	\$ -	8,497,335	-	8,497,335
Building and improvements	-	90,002,665	-	90,002,665
Equipment and furniture	-	402,497	-	402,497
Total	-	98,902,497	-	98,902,497
Less accumulated depreciation	-	(1,892,495)	-	(1,892,495)
Property, plant, and equipment, net	\$ -	97,010,002	-	97,010,002

With the creation of the District, the City of Austin conveyed ownership of assets associated with Brackenridge/Children's Hospital, the Austin Women's Hospital, and medical equipment used in the health care clinics to the District. Travis County conveyed medical equipment used in the health care clinics to the District. The City of Austin also donated an office building to the District. The conveyed and donated assets were recorded at fair market value at the date of receipt.

6. OPERATING LEASE WITH SETON

Effective October 1, 2004, the District assumed the rights and obligation from the City of Austin related to a long-term lease agreement with Seton. Under the terms of the lease, Seton will operate Brackenridge/Children's Hospital and will provide all necessary medical services for residents of Travis County regardless of their ability to pay. The lease term is for 60 years through September 2055 with an optional 30 year extension. The breach of contract penalty is \$50 million and Seton is required to spend a minimum of \$50 million for capital improvements at Brackenridge/Children's Hospital by 2023; of which \$30 million must be spent by 2013.

At September 30, 2005, the District's investment in Brackenridge/Children's Hospital consists of land valued at \$8,013,662 and buildings and improvements valued at \$85,786,338 less accumulated depreciation of \$1,715,727. For the year ended September 30, 2005, lease revenue of \$1,096,656 was recognized under this lease.

Pursuant to the terms of the lease, the District will reimburse Seton for services provided through three programs. Under the Charity Care Program, the District will reimburse Seton a maximum of \$5,600,000 annually for providing medical care to the medically indigent; provided however, that Seton must first provide charity care in the amount of 4% of net revenues as required by State law. Under the Physicians Services Program, the District paid Seton \$5,898,192 for the year ended September 30, 2005 for providing physician services to patients in the first two programs. Under the Home Health Services Program, the District paid Seton \$250,000 for the year ended September 30, 2005 for home health services for the medically indigent of Travis County.

Under the Medical Assistance Program ("MAP"), the District paid Seton \$14,471,003 for the year ended September 30, 2005 for patients enrolled in this program. These payments are made

through the interlocal agreement with the City of Austin discussed in Note 8 as the City of Austin operates MAP.

The future minimum lease payments to be received from Seton are as follows:

2006	\$ 1,096,656
2007	1,096,656
2008	1,096,656
2009	1,096,656
2010	1,096,656
Thereafter	<u>16,749,840</u>
Total	<u>\$ 22,233,120</u>

7. LEASE AGREEMENT WITH THE UNIVERSITY OF TEXAS MEDICAL BRANCH AT GALVESTON (“UTMB”)

Effective October 1, 2004, the District assumed the rights and obligation from the City of Austin related to the lease agreement with UTMB. Under the terms of the agreement, UTMB will operate Austin Women’s Hospital for an initial term of five years through January 2009 with an option to renew. For the year ended September 30, 2005, lease revenue of \$58,740 was recognized under this lease. Pursuant to the terms of the lease, the District paid UTMB \$3,100,000 for the year ended September 30, 2005 for charity care provided at Austin Women’s Hospital.

At September 30, 2005, the District’s investment in Austin Women’s Hospital consists of buildings and improvements valued at \$3,400,000 less accumulated depreciation of \$68,000.

The future minimum lease payments to be received from UTMB are as follows:

2006	\$ 58,740
2007	58,740
2008	58,740
2009	<u>19,580</u>
Total	<u>\$ 195,800</u>

8. DISPROPORTIONATE SHARE III AND UPPER PAYMENT LIMIT PROGRAMS

The Disproportionate Share III (“DSH”) program was created in fiscal year 1992 by the State of Texas to access additional federal matching funds. These funds are distributed to selected hospitals that provide services to low-income and uninsured patients. According to the DSH program guidelines, the District may use the funds for the benefit of the indigent in either the immediate period or future periods.

The Upper Payment Limit (“UPL”) program was created in May 2002 with an effective date of July 2001. The UPL program uses federal matching funds to raise state Medicaid reimbursement

rates to 100% of equivalent Medicare rates for certain public hospital systems.

The District recognizes all funds received under the DSH and UPL programs as operating revenues in the period of receipt of the funds.

A portion of the DSH and UPL payments received are due to Seton under the operating lease discussed in Note 4. This payment is to be reduced by the charity care payment to UTMB. During the year ended September 30, 2005, the District paid \$11,741,456 to Seton which is net of the \$3,100,000 paid to UTMB discussed in Note 7. The DSH/UPL program revenue of \$28,029,577 is netted by the \$11,741,456 paid to Seton.

9. INTERLOCAL AGREEMENT WITH THE CITY OF AUSTIN

Effective October 1, 2004, the District entered into an agreement with the City of Austin to operate the Federally Qualified Health Centers and administer MAP which were previously the responsibility of the City of Austin and Travis County. The agreement term is for one year with annual renewal possibility for four years. Under the agreement, payments are due monthly from the District. For the year ended September 30, 2005, the District recorded \$41,774,738 of health care delivery expense related to this agreement. Any excess of revenues over expenses of the clinic operations is due to the District at the end of the agreement term. At September 30, 2005, the District has recorded a receivable from the City of Austin of \$2,871,776 related to this excess although this amount will remain with the City of Austin for clinic operations in the following year.

The receivable from the City of Austin is comprised of the following at September 30, 2005:

Operating revenues:	
Medicare	\$ 982,449
Medicaid	5,346,338
Managed Medicare	323,000
CHIP	94,266
Net patient service revenue	814,096
Grant revenue	8,215,119
Interest income	156,012
Total operating revenues	15,931,280
Operating expenses:	
Salaries and benefits	21,387,737
Contracted services	27,024,610
Purchased goods	5,140,895
Total operating expenses	53,553,242
Other revenues (expenses):	
Payments received from the District	41,774,738
Construction in progress payment	(1,281,000)
Total other revenues	40,493,738
Excess of revenues over expenses	<u>\$ 2,871,776</u>

10. APPRAISAL DISTRICT AND AD VALOREM TAXES

The Texas Legislature in 1979 adopted a comprehensive Property Tax Code (the "Code") which established a county-wide appraisal district and an appraisal review board in each county in the State. The Appraisal District is responsible for the recording and appraisal of all property in the District. Under the Code, the District sets the tax rates on property with the approval of Travis County Commissioner's Court. The Travis County Tax Assessor-Collector provides tax collection services. The Appraisal District is required under the Code to assess property at 100% of its appraised value. Further, real property must be reappraised at least every four years. Under certain circumstances, taxpayers and taxing units, including the District, may challenge orders of the Appraisal District's review board through various appeals and, if necessary, legal action.

Property taxes are levied as of October 1 in conformity with Subtitle E, Texas Property Tax Code. Taxes are due on receipt of the tax bill and are delinquent if not paid before February 1 of the year following the year in which imposed. On January 1 of each year, a tax lien attaches to property to secure the payment of all taxes and penalties and interest that are ultimately imposed. The assessed value at January 1, 2004, upon which the October 2004 levy was based was \$61,067,328,293. The District levied taxes based on a tax rate of \$0.0779 per \$100 of assessed valuation.

11. INTERLOCAL AGREEMENT WITH TRAVIS COUNTY

The District entered into an interlocal agreement with Travis County in which Travis County provides legal and other services for the District along with the tax collections services discussed in Note 9. For the year ended September 30, 2005, \$135,911 is included in other purchased goods and services for the legal and other services. For the year ended September 30, 2005, \$338,049 is netted against net ad valorem tax revenue for the tax collections services. At September 30, 2005, \$29,188 is included in due to other governments related to this agreement.



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**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER
FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED
IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***

The Board of Managers of
Travis County Hospital District:

We have audited the financial statements of Travis County Hospital District (the "District"), a component unit of Travis County, Texas, as of and for the year ended September 30, 2005, which collectively comprise the District's financial statements and have issued our report thereon dated November 18, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the District's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the District's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the board of managers and management, and is not intended to be and should not be used by anyone other than these specified parties.

Maxwell Locke & Ritter LLP

November 18, 2005

Affiliated Companies
ML&R PERSONNEL SOLUTIONS LLC
"The Resource for Direct Hire & Project Staffing"
ML&R WEALTH MANAGEMENT LLC^o
"A Registered Investment Advisor"
^oThis firm is not a CPA firm