TRAVIS COUNTY HEALTHCARE DISTRICT (formerly TRAVIS COUNTY HOSPITAL DISTRICT), A COMPONENT UNIT OF TRAVIS COUNTY, TEXAS

Financial Statements for the Years Ended September 30, 2006 and 2005 and Independent Auditors' Report

MAXWELL LOCKE & RITTER

TRAVIS COUNTY HEALTHCARE DISTRICT
(formerly TRAVIS COUNTY HOSPITAL DISTRICT),
A COMPONENT UNIT OF TRAVIS COUNTY, TEXAS

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INDEPENDENT AUDITORS' REPORT

The Board of Managers of
Travis County Healthcare District:

We have audited the accompanying statements of net assets of Travis County Healthcare District (the "District") (formerly Travis County Hospital District), a component unit of Travis County, Texas, as of September 30, 2006 and 2005, and the related statements of revenues, expenses, and changes in net assets and cash flows for the years 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 audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free 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 audits provide 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, 2006 and 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 15, 2006, 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 assessing the results of our audit.

The management's discussion and analysis on pages 3 through 9, 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 15, 2006

MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of the Travis County Healthcare District's (the "District") (formerly the Travis County Hospital District) financial report presents background information and management's analysis of the District's financial results for the fiscal years ended September 30, 2006 and 2005. 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. During fiscal year 2006, with the approval of Travis County Commissioners' Court, the District changed it name from Travis County Hospital District to Travis County Healthcare District to better reflect the activities of the District.

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 2006 tax levy for the District is $0.0779 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 guidelines (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

- The District's net assets increased $25.7 million which is a 20% increase over prior year.
- During the year, the District's net operating revenue was $37.8 million and operating expenses were $66.9 million. Nonoperating revenue, comprised primarily of property tax, was $54.8 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. The District increased unallocated reserves to 90 days cash on hand and established a capital reserve equal to depreciation expense. The District's reserve policy will be reviewed annually in association with the budget process.
- Services that were expanded or initiated:
  - Opening of the Far North clinic.
  - Increase in enrollment in the medical assistance program by 18%.
  - Funding of inpatient mental health beds to assist with over utilization of the Austin State Hospital.
- The District undertook a major strategic planning initiative to build upon work started in the initial year.

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, 2006 and 2005:

TABLE 1
Condensed Statement of Net Assets

	2006	2005	% Fluctuation
Current and other assets	$ 66,392,700	45,701,566	45%
Capital assets	95,117,507	97,010,002	(2%)
Total assets	161,510,207	142,711,568	13%
Current liabilities	4,815,590	11,720,415	(59%)
Invested in capital assets	95,117,507	97,010,002	(2%)
Unrestricted	61,577,110	33,981,151	81%
Total net assets	$ 156,694,617	130,991,153	20%

As can be seen in Table 1, net assets were $156.7 million at September 30, 2006 and $131.0 million at September 30, 2005. The change in net assets is primarily the result of operations of $25.7 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 years ended September 30, 2006 and 2005:

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

	2006	2005	% Fluctuation
Operating revenues:			
DSH/UPL program	$ 36,670,256	28,029,577	31%
Operating lease revenue	1,155,396	1,155,396	-
Total operating revenues	37,825,652	29,184,973	30%
Operating expenses:			
Health care delivery	63,669,603	56,036,996	14%
Salaries and benefits	568,980	160,410	255%
Other purchased goods and services	818,084	423,808	93%
Depreciation	1,892,495	1,892,495	-
Total operating expenses	66,949,162	58,513,709	14%
Operating loss	(29,123,510)	(29,328,736)	(1%)
Nonoperating revenues (expenses):			
Net ad valorem tax revenue	49,533,162	46,299,165	7%
Net tobacco settlement revenue	2,489,720	1,165,771	114%
Investment income	2,803,272	690,752	306%
Other revenue	820	-	-
Total nonoperating revenues	54,826,974	48,155,688	14%
Income before other changes in net assets	25,703,464	18,826,952	37%
Contributions	-	112,164,201	(100%)
Change in net assets	25,703,464	130,991,153	(80%)
Total net assets – beginning of year	130,991,153	-	-
Total net assets – end of year	$ 156,694,617	130,991,153	20%

The District's operating revenue was $37.8 million, comprised of $36.7 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 $29.1 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 $54.8 million, comprised of net property taxes of $50.1 million, net tobacco settlement revenue of $2.5 million and investment income of $2.8 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

	2006	2005	% Fluctuation
Land and improvements	$ 8,497,335	8,497,335	-
Buildings and improvements	90,002,665	90,002,665	-
Equipment and furniture	402,497	402,497	-
Subtotal	98,902,497	98,902,497	-
Less accumulated depreciation	(3,784,990)	(1,892,495)	100%
Net property, plant, and equipment	$ 95,117,507	97,010,002	(2%)

The District's budget for fiscal year 2006 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 2006 actual amounts.

TABLE 4
Budget vs. Actual

	Budget 2006	Actual 2006	Favorable (Unfavorable) Variance
Operating revenues:			
DSH/UPL program	$ 16,069,048	36,670,256	20,601,208
Operating lease revenue	1,155,396	1,155,396	-
Total operating revenues	17,224,444	37,825,652	20,601,208
Other expenses:			
Health care delivery	67,700,312	63,669,603	4,030,709
Salaries and benefits	677,945	568,980	108,965
Other purchased goods and services	900,302	818,084	82,218
Depreciation	1,789,690	1,892,495	(102,805)
Total operating expenses	71,068,249	66,949,162	4,119,087
Operating loss	(53,843,805)	(29,123,510)	24,720,295
Nonoperating revenues (expenses):			
Net ad valorem tax revenue	48,712,910	50,107,980	1,395,070
Tax assessment and collection expense	(590,994)	(574,818)	16,176
Tobacco settlement revenue	3,303,925	4,199,541	895,616
Tobacco settlement expense	(1,709,821)	(1,709,821)	-
Investment income	743,239	2,803,272	2,060,033
Other revenue	-	820	820
Total nonoperating revenues	50,459,258	54,826,974	4,367,716
Income before other changes in net assets	(3,384,547)	25,703,464	28,088,011
Change in net assets	$ (3,384,547)	25,703,464	28,088,011

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 $20.6 million and this increase is due to monies received related to the DSH and UPL programs.

Actual operating expenses were under budget by $4.1 million primarily related to health care delivery costs associated with the operation of the community health care clinic. The District was able to achieve income of $28.1 million greater than planned.

Economic Conditions and Plan for Fiscal Year 2007

In planning for fiscal year 2007, 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:

- Continued 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 2007 tax rate of $0.0734 per $100 valuation decreased from $0.0779 in 2006.

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

TRAVIS COUNTY HEALTHCARE DISTRICT
(formerly TRAVIS COUNTY HOSPITAL DISTRICT),
A COMPONENT UNIT OF TRAVIS COUNTY, TEXAS

STATEMENTS OF NET ASSETS
SEPTEMBER 30, 2006 AND 2005

	2006	2005
ASSETS		
Current assets:		
Cash and cash equivalents	$ 30,593	38,332
Short-term investments	54,599,411	42,447,382
Ad valorem taxes receivable, net of allowance for uncollectible taxes of $83,368 and $50,435	207,657	163,408
Due from other governments	10,467,562	2,876,671
Other receivables	1,023,488	174,288
Prepaid expenses	63,989	1,485
Total current assets	66,392,700	45,701,566
Capital assets:		
Land	8,497,335	8,497,335
Buildings and improvements	90,002,665	90,002,665
Equipment and furniture	402,497	402,497
Less accumulated depreciation	(3,784,990)	(1,892,495)
Total capital assets, net	95,117,507	97,010,002
Total assets	161,510,207	142,711,568
LIABILITIES		
Current liabilities:		
Accounts payable	4,680,457	11,667,695
Salaries and benefits payable	71,635	23,532
Due to other governments	63,498	29,188
Total current liabilities	4,815,590	11,720,415
NET ASSETS		
Invested in capital assets	95,117,507	97,010,002
Unrestricted	61,577,110	33,981,151
Total net assets	$ 156,694,617	130,991,153

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

TRAVIS COUNTY HEALTHCARE DISTRICT
(formerly TRAVIS COUNTY HOSPITAL DISTRICT),
A COMPONENT UNIT OF TRAVIS COUNTY, TEXAS

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS YEARS ENDED SEPTEMBER 30, 2006 AND 2005

	2006	2005
Operating revenues:		
DSH/UPL program	$ 36,670,256	28,029,577
Operating lease revenue	1,155,396	1,155,396
Total operating revenues	37,825,652	29,184,973
Operating expenses:		
Health care delivery	63,669,603	56,036,996
Salaries and benefits	568,980	160,410
Other purchased goods and services	818,084	423,808
Depreciation	1,892,495	1,892,495
Total operating expenses	66,949,162	58,513,709
Operating loss	(29,123,510)	(29,328,736)
Nonoperating revenues (expenses):		
Ad valorem tax revenue	50,107,980	46,816,179
Tax assessment and collection expense	(574,818)	(517,014)
Tobacco settlement revenue	4,199,541	1,471,021
Tobacco settlement expense	(1,709,821)	(305,250)
Investment income	2,803,272	690,752
Other revenue	820	-
Total nonoperating revenues	54,826,974	48,155,688
Income before other changes in net assets	25,703,464	18,826,952
Contributions:		
Contributions from the City of Austin, Texas	-	109,602,497
Contributions from Travis County, Texas	-	2,560,807
Other contributions	-	897
Total contributions	-	112,164,201
Change in net assets	25,703,464	130,991,153
Total net assets - beginning of year	130,991,153	-
Total net assets - end of year	$ 156,694,617	130,991,153

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

TRAVIS COUNTY HOSPITAL DISTRICT
(formerly TRAVIS COUNTY HOSPITAL DISTRICT), A COMPONENT UNIT OF TRAVIS COUNTY, TEXAS

STATEMENT OF CASH FLOWS
YEARS ENDED SEPTEMBER 30, 2006 AND 2005

	2006	2005
Cash flows from operating activities:		
Cash received from DSH/UPL program	$ 77,655,270	85,482,921
Cash payments for DSH/UPL program	(55,234,803)	(48,350,829)
Cash received from operating leases	1,155,396	1,150,501
Cash payments for goods and services	(65,627,984)	(56,913,985)
Cash payments to employees	(520,877)	(136,878)
Net cash used in operating activities	(42,572,998)	(18,768,270)
Cash flows from noncapital financing activities:		
Ad valorem taxes received	50,063,731	46,652,771
Payments for tax assessment and collection	(574,818)	(517,014)
Tobacco settlement received	4,199,541	1,471,021
Tobacco settlement paid	(1,709,821)	(305,250)
Other nonoperating revenue received	820	-
Net cash provided by noncapital financing activities	51,979,453	47,301,528
Cash flows from capital and related financing activities -		
Contributions	-	13,261,704
Cash flows from investing activities:		
Receipts of interest income	2,561,876	631,568
Net sales of investment pools	7,638,122	(47,380,500)
Purchase of investment securities	(22,614,192)	-
Proceeds from maturities of investment securities	3,000,000	4,992,302
Net cash used in investing activities	(9,414,194)	(41,756,630)
Net increase in cash and cash equivalents	(7,739)	38,332
Cash and cash equivalents - beginning of year	38,332	-
Cash and cash equivalents - end of year	$ 30,593	38,332
Reconciliation of operating loss to net cash used in operating activities:		
Operating loss	$ (29,123,510)	(29,328,736)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation expense	1,892,495	1,892,495
Changes in operating assets and liabilities that provided (used) cash:		
Due from other governments	(7,590,891)	(2,876,671)
Other receivables	(783,763)	(174,288)
Prepaid expenses	(62,504)	(1,485)
Accounts payable	(6,987,238)	11,667,695
Salaries and benefits payable	48,103	23,532
Due to other governments	34,310	29,188
Net cash used in operating activities	$ (42,572,998)	(18,768,270)
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.

1. ORGANIZATION AND MISSION

Travis County Healthcare District (the "District") (formerly Travis County Hospital 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 May 2006, the Travis County Commissioners' Court approved a name change to the Travis County Healthcare District to better reflect the activities of the District.

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 fourteen 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 - Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed by the District to the extent that those standards do not conflict or contradict guidance of the 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.

Capital Assets - Capital assets 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 capital assets 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 20 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 $4,199,541 and $1,471,021 associated with the settlement in the years ended September 30, 2006 and 2005, respectively. Settlement revenues for fiscal year 2007 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.

During the year ended September 30, 2006, the District paid $1,310,484 of the tobacco settlement revenue to the Daughters of Charity Health Services of Austin ("Seton") and $399,337 to Travis County which represents their respective share of healthcare expenditures claimed. During the year ended September 30, 2005, the District paid $262,624 of the tobacco settlement revenue to 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

The District has developed a formal investment policy for the District that is consistent with State statutes. The policy states the District will use the "prudent person rule" in investment decisions. The objectives of the District policy are to ensure the safety of the principal, maintain adequate liquidity, and yield to the highest possible return subject to the first two principles.

The District's depository agreement with JPMorgan Chase Bank requires collateralization with a fair market value equal to at least 102% of District funds in excess of $100,000 on deposit in the bank. All of the pledged collateral for the District's demand deposits and time deposits are U.S. Treasury securities or U.S. Government agency securities. The depository agreement states that collateral shall consist of one or more of the following: U.S. Treasury securities, Federal National Mortgage Association ("FNMA") securities, pools or REMIC CMO's; Federal Farm Credit Bank ("FFCB") securities, Federal Home Loan Bank ("FHLB") agencies, Federal Home Loan Mortgage Corporation ("FHLMC") pools or REMIC CMO's; Government National Mortgage Association (GNMA) pools, obligations of states, agencies, counties, cities, and other political subdivisions of any state that are rated not less than "A" or its equivalent. The REM1C CMO's must not have variable rates or original maturities longer than ten years.

This collateral is held by the Federal Reserve Bank of New York which in the case of default by JPMorgan Chase wiil act as agent for District, in a fiduciary account held in the name of JPMorgan Chase and District and pledged to District. During fiscal year 2006, there was one instance in November 2005 where the bank balances were not fully collateralized at all times. As of September 30, 2006, the District's bank balances in excess of federal depository insurance were fully collateralized.

Deposits are stated at cost plus accrued interest, if any, and the carrying amounts are displayed on the balance sheet as cash and cash equivalents

The District is authorized to purchase, sell, and invest its funds and funds under its control in accordance with the Texas Public Funds Investment Act, Government Code Chapter 2256 and its subsequent amendments. During the fiscal period, investments consisted of U.S. government treasury securities, U.S. government agencies securities, and participation in two local government investment pools (TexPool and TexasTERM). The carrying amount of investments as of September 30, 2006, is displayed on the balance sheet as short-term investments.

The District's adoption of GASB Statement No. 31 requires some investments be reported at fair value. Money market investments and participating interest-earning investment contracts with a remaining maturity at the time of purchase of one year or less are reported at amortized cost. TexPool operates in a manner consistent with the SEC's Rule 2a7 of the Investment Company Act of 1940. TexPool uses amortized cost rather than market value to report net assets to compute share prices. Accordingly, the fair value of the position in TexPool is the same as the value of TexPool shares. The State Comptroller of Public Accounts exercises oversight responsibility over TexPool. Oversight includes the ability to significantly influence operations, designation of management and accountability for fiscal matters. Additionally, the State Comptroller has established an advisory board composed of both participants in TexPool and other persons who do not have a business relationship with TexPool. The advisory board members review the investment policy and management fee structure.

TexasTERM is organized in conformity with the Texas Public Funds Investment Act of the Texas Government Code. It provides for a fixed-rate, fixed-term investment for a period of 60 days to one year and includes TexasDAILY, a portfolio of the Local Government Pool, providing daily access to funds. An advisory board, composed of participants in TexasTERM and other parties who do not participate in the pool, has responsibility for the overall management of the pool, including formulation and implementation of its investment and operating policies. PFM Asset Management LLC, a leading national financial and investment advisory firm, is the investment advisor to the pool.

TexPool and TexasTERM are both rated AAAm by Standard & Poor's. As a requirement to maintain the rating, weekly portfolio information must be submitted to Standard & Poor's, as well as the office of the Comptroller of Public Accounts, for review.

As of September 30, 2006, the District had the following investments:

Type	Fair Value	Weighted Average Maturity (Years)
Local government investment pools	$ 34,809,260	0.00
U.S. government treasuries	13,797,151	0.74
U.S. government agencies	5,993,000	0.82
Total fair value	$ 54,599,411	
Portfolio weighted average maturity		0.28

Interest Rate Risk - In accordance with its investment policy, the District manages its exposure to declines in fair values by limiting the weighted average maturity of its investment portfolio to one year or less. Individual security types are limited as well, with the longest permitted maturity of three years for government treasuries and government agencies.

Credit Risk - State law limits investment in municipal bonds to an A rating or its equivalent by a nationally recognized investment rating firm. However, the District requires AA by Moody's Investors Service or Standard & Poor's Corporation. For commercial paper, state law limits investments to a rating not less than A-1 by Standard & Poor's or P-1 by at least two nationally recognized credit rating agencies. The District's investment policy limits commercial paper to a rating not less than A-1 by Standard & Poor's and P-1 by Moody's Investors Service. The District does not have credit limits on government agency securities. The District's investments in government agencies carry the implicit guarantee of the U.S. government. The District's investment policy requires that certificates of deposits be either federally insured or collateralized.

Investment at September 30, 2006	Standard & Poor's Rating
Local government investment pools	AAAm
Federal National Mortgage Association	AAA
Federal Home Loan Mortgage Association	AAA
Federal Home Loan Bank	AAA

Concentration of Credit Risk - The District's investment policy limits the percentage of the combined portfolios for each type of eligible investment to reduce the risk of principal loss. No individual investment made up at least 5% of the District's investment portfolio.

Investment at September 30, 2006	% of Portfolio	Portfolio Limit
Local government investment pool - TexPool	41%	80%
Other local government investment pools	23%	40%
U.S. government treasuries	25%	100%
U.S. government agencies	11%	75%

4. DISAGGREGATION OF RECEIVABLE BALANCES

The District's receivables, including the applicable allowances, are comprised of the following as of September 30, 2006:

	Taxes	Due from Other Governments	Other	Total
Total	$ 833,676	10,467,562	1,023,488	12,324,726
Less:				
Allowance for uncollectibles	(83,368)	-	-	(83,368)
Allowance for long-term collections	(542,651)	-	-	(542,651)
Total, net	$ 207,657	10,467,562	1,023,488	11,698,707
Amounts not scheduled for collection during the subsequent year	$ 397,138	-	-	397,138

At September 30, 2006, due from other governments balance is comprised of $7,995,154 related to the Upper Payment Limit program (see Note 8), $2,204,513 due from the City of Austin (see Note 9), $4,895 related to the UTMB lease of Austin Women's Hospital (see Note 7), and $263,000 related to the charity care provided by UTMB at Austin Women's Hospital (see Note 7).

At September 30, 2006, other receivables balance is comprised of $958,051 due from Seton (see Note 6) and $65,437 of accrued interest on investments.

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	(290,504)	-	-	(290,504)
Total, net	$ 163,408	2,876,671	174,288	3,214,367
Amounts not scheduled for collection during the subsequent year	$ 220,129	-	-	220,129

At September 30, 2005, due from other governments balance is comprised of $2,871,776 due from the City of Austin (see Note 9) and $4,895 related to the UTMB lease of Austin Women's Hospital (see Note 7).

At September 30, 2005, other receivables balance is comprised of $174,288 due from Seton (see Note 6).

5. CAPITAL ASSETS

The District's capital assets are comprised of the following as of September 30, 2006:

	Beginning Balance	Increases	Decreases	Ending Balance
Capital assets not being depreciated-				
Land	$ 8,497,335	-	-	8,497,335
Capital assets being depreciated:				
Building and improvements	90,002,665	-	-	90,002,665
Equipment and furniture	402,497	-	-	402,497
Total capital assets being depreciated	90,405,162	-	-	90,405,162
Less accumulated depreciation for:				
Building and improvements	(1,824,543)	(1,824,543)	-	(3,649,086)
Equipment and furniture	(67,952)	(67,952)	-	(135,904)
Total accumulated depreciation	(1,892,495)	(1,892,495)	-	(3,784,990)
Total capital assets being depreciated	88,512,667	(1,892,495)	-	86,620,172
Capital assets, net	$ 97,010,002	(1,892,495)	-	95,117,507

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, 2006, 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 $3,431,454. For the years ended September 30, 2006 and 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 $6,484,548 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 years ended September 30, 2006 and 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 years ended September 30, 2006 and 2005, for home health services for the medically indigent of Travis County.

Under the Medical Assistance Program ("MAP"), the District paid Seton $18,717,918 and $14,471,003 for the years ended September 30, 2006 and 2005, respectively, for patients enrolled in this program. The payments through February 2006 were made through the interlocal agreement with the City of Austin discussed in Note 8 as the City of Austin was the party responsible for the MAP contract with Seton until that time. At the end of that contract period, the District assumed responsibility for MAP payments, contracted with and made payments to Seton directly.

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

2007	$ 1,096,656
2008	1,096,656
2009	1,096,656
2010	1,096,656
2011	1,096,656
Thereafter	15,653,184
Total	$ 21,136,464

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 years ended September 30, 2006 and 2005, lease revenue of $58,740 was recognized under this lease. Pursuant to the terms of the lease, the District paid UTMB $3,877,048 and $3,100,000 for the years ended September 30, 2006 and 2005, for charity care provided at Austin Women's Hospital. At September 30, 2006, UTMB owes $263,000 to the District of excess operating income of the Austin Women's Hospital.

At September 30, 2006, the District's investment in Austin Women's Hospital consists of buildings and improvements valued at $3,400,000 less accumulated depreciation of $136,000.

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

2007	$	58,740
2008		58,740
2009		19,580
Total	$	137,060

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, 2006, the District paid $15,700,205 to Seton which is net of the $3,877,048 paid to UTMB discussed in Note 7. The DSH/UPL program revenue of $36,670,256 is netted by the $15,700,205 paid to Seton. 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 years ended September 30, 2006 and 2005, the District recorded $34,140,236 and $41,774,738, respectively, 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, 2006, the District has recorded a receivable from the City of Austin of $2,204,513 related to this excess although this amount will remain with the City of Austin and offset payments from the District to the City of Austin in the following year.

The receivable from the City of Austin is comprised of the following at September 30, 2006 and 2005:

	2006	2005
Operating revenues:		
Medicare	$ 1,288,899	$ 982,449
Medicaid	5,397,685	5,346,338
Managed Medicare	-	323,000
CHIP	72,898	94,266
Net patient service revenue	731,093	814,096
Grant revenue	912,007	8,215,119
Interest income	332,773	156,012
Total operating revenues	8,735,355	15,931,280
Operating expenses:		
Salaries and benefits	20,911,762	21,387,737
Contracted services	15,562,057	27,024,610
Purchased goods	2,997,259	5,140,895
Total operating expenses	39,471,078	53,553,242
Other revenues (expenses):		
Payments received from the District	34,140,236	41,774,738
Construction in progress payment	(1,200,000)	(1,281,000)
Total other revenues	32,940,236	40,493,738
Excess of revenues over expenses	$ 2,204,513	$ 2,871,776

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 three 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, 2005, upon which the October 2005 levy was based was $63,484,891,844. The District levied taxes based on a tax rate of $0.0779 per $100 of assessed valuation. 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 AGREEMENTS 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 years ended September 30, 2006 and 2005, $331,342 and $135,911, respectively, is included in other purchased goods and services for the legal and other services. For the years ended September 30, 2006 and 2005, $332,904 and $338,049, respectively, is included in tax assessment and collection expense for the tax collections services. At September 30, 2006 and 2005, $63,498 and $29,188, respectively, is included in due to other governments related to this agreement.

During fiscal year 2006, the District entered into an interlocal agreement with Travis County in which Travis County provides supplemental dental, life, and disability insurance. For the year ended September 30, 2006, fees of $3,844 were included in other purchased goods and services related to this agreement.

12. DEFERRED COMPENSATION PLAN

The District offers its employees a deferred compensation plan established in accordance with Internal Revenue Code Section 457. Assets and income of the District's plan are administered by a private corporation under contract with the District and are held for the exclusive benefit of the participants and their beneficiaries. Accordingly, the plan's assets and liabilities are not recorded in the District's basic financial statements. The District contributed $29,065 and $5,701 to the plan during the years ended September 30, 2006 and 2005, respectively.

13. HEALTH CARE COVERAGE

During the year ended September 30, 2006, employees of the District were covered by a health insurance plan. The District contributed $404 per month per employee to the plan as well as half of the cost of family coverage if applicable, and employees, at their option, authorized payroll withholdings to pay contributions or premiums for dependents. All contributions were paid to a licensed insurer. The plan was documented by a contractual agreement.

14. RISK MANAGEMENT

The District's risk management program includes coverages through third party insurance providers for officers' professional liability and workers compensation. During the year ended September 30, 2006, there were no reductions in insurance coverage from coverage in the prior year and there have been no claims.

15. NEW ACCOUNTING STANDARDS

The GASB issued Statement No. 43, *Financial Reporting for Post-employment Benefit Plans Other than Pension Plans*, which will be effective for the District in the fiscal year ending September 30, 2007. It establishes uniform financial reporting standards for other post-employment benefit ("OPEB") plans and supersedes the interim guidance included in GASB Statement No. 26, *Financial Reporting for Post-employment Healthcare Plans Administered by Defined Benefit Pension Plans*.

The GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Post-employment Benefits Other Than Pensions*, which will be effective for the District in the fiscal year ending September 30, 2008. GASB Statement No. 45 requires state and local governments to establish standards for the measurement, recognition, and display of other post employment benefits expense/expenditures, related liabilities and note disclosures in the financial statements.

The District currently does not provide post-employment benefits for it's employees and does not believe that these GASB Statements will have an impact on the District's financial statements.

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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 Healthcare District:

We have audited the financial statements of Travis County Healthcare District (the "District") (formerly Travis County Hospital District), a component unit of Travis County, Texas, as of and for the year ended September 30, 2006, which collectively comprise the District's financial statements and have issued our report thereon dated November 15, 2006. 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 15, 2006