

**HARRIS COUNTY  
IMPROVEMENT DISTRICT NO. 1**

**HOUSTON, TEXAS**

**FINANCIAL REPORT**

**June 30, 2004**



HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1  
FINANCIAL REPORT  
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## **FINANCIAL SECTION**



11 Greenway Plaza, Suite 1515  
Houston, TX 77046  
(713) 621-1515  
Fax: (713) 621-1570



2117 Post Office  
Galveston, TX 77550  
(409) 762-8380  
Fax: (409) 762-1749

## **Independent Auditors' Report**

Board of Directors  
Harris County Improvement District No. 1  
Houston, Texas

We have audited the accompanying financial statements of the governmental activities and each major fund of Harris County Improvement District No. 1 (the "District"), as of and for the year ended June 30, 2004, which collectively comprise the District's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the District's management. Our responsibility is to express opinions 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. 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 opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the District's governmental activities and each major fund as of June 30, 2004, and the respective changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As described in Note 2, the District has implemented a new financial reporting model, as required by the provisions of GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, as of July 1, 2003.

The management's discussion and analysis and budgetary comparison information on pages 3 through 7 and page 26 are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. The required supplementary information schedules are the responsibility of the Authority's management. 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.

*Null-Lairson, P.C.*

Houston, Texas  
August 24, 2004





## Management's Discussion and Analysis

As management of the Harris County Improvement District #1, we offer readers of the District's financial statements this narrative overview and analysis of the financial activities of the District for the fiscal year ended June 30, 2004.

### **Overview of the Financial Statements**

This discussion and analysis are intended to serve as an introduction to the District's basic financial statements. The District's basic financial statements comprise three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements. This report also contains required supplementary information in addition to the basic financial statements themselves.

#### **Government-wide financial statements.**

The government-wide financial statements are designed to provide readers with a broad overview of the District's finances, in a manner similar to a private-sector business.

The statement of net assets presents information on all of the District's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator regarding the financial position of the District. Other factors that are not included in the financial statements, such as increased tax base in the District's boundaries, should be considered in evaluating the condition of the District's overall financial position.

The statement of activities presents information showing how the government's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods.

The government-wide financial statements can be found on pages 8-9 of this report.

#### **Fund financial statements.**

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The District, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the District's funds are considered governmental funds.

#### **Governmental funds**

Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

The District maintains three individual governmental funds. Information is presented separately in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures, and changes in fund balances for the general fund, the debt service fund and the capital projects fund, all of which are considered to be major funds.

The District adopts an annual appropriated budget for its general fund. A budgetary comparison statement has been provided for the general fund to demonstrate compliance with this budget.

The basic governmental fund financial statements can be found on pages 10-13 of this report.

### **Notes to the financial statements**

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements can be found on pages 14-25 of this report.

### **Government-wide Financial Analysis**

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. In the case of the District, net assets were a negative of approximately \$2 million as of June 30, 2004. The principal reason for this deficit is the conveyance of approximately \$2 million in infrastructure improvements to the City of Houston's Right of Way. The District incurred long-term debt in 1999 for these improvements.

At year end, the District had total assets of approximately \$14 million. Of this amount, approximately \$7.6 million consisted of cash and temporary investments and approximately \$6 million of capital assets. The balance of the assets consists of various receivable amounts and prepaid expenses.

Total liabilities were approximately \$16 million as of year end. Of this amount, approximately \$15.6 million consisted of long term debt and accrued interest. The balance of the liabilities consists of accounts payable and accrued expenses.

A schedule of net assets at June 30, 2004 follows:

HARRIS COUNTY IMPROVEMENT DISTRICT'S NET ASSETS  
 JUNE 30, 2004  
 AMOUNTS IN (000'S)

	Governmental Activities
Current and other assets	\$ 8,064
Capital assets	6,048
<b>Total Assets</b>	<u>14,112</u>
Other liabilities	449
Long-term liabilities outstanding	15,618
<b>Total Liabilities</b>	<u>16,067</u>
Net assets:	
Invested in capital assets, net of related debt	(4,514)
Restricted	937
Unrestricted	1,622
<b>Total Net Assets</b>	<u>\$ (1,954)</u>

Changes in net assets for the year ended June 30, 2004 follows:

HARRIS COUNTY IMPROVEMENT DISTRICT'S  
 CHANGES IN NET ASSETS  
 JUNE 30, 2004  
 AMOUNTS IN (000'S)

	Governmental Activities
Revenues	
Program revenue	
Charges for services	\$ 1,251
General revenues	
Property taxes	3,206
Unrestricted investment earnings	20
Miscellaneous	171
<b>Total Revenues</b>	<u>4,648</u>
Expenses	
General and administrative	1,237
Traffic control	782
Maintenance and beautification	974
Uptown	338
Planning and engineering	95
Marketing and communications	174
Interest on Long-term debt	725
Economic development	44
Metro	489
Construction on behalf of the City of Houston	51
<b>Total Expenses</b>	<u>4,909</u>
Decrease in net assets	(261)
Net assets-beginning	(1,694)
<b>Net Assets - Ending</b>	<u>\$ (1,954)</u>

## *Financial Analysis of the Government's Funds*

As noted earlier, the District uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

### **Governmental funds**

The focus of the District's governmental funds is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the District's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

As of the end of the current fiscal year, the District's governmental funds reported combined ending fund balances of approximately \$7.4 million, an increase of \$4.8 million in comparison with the prior year. This increase is primarily due to the issuance of additional long term debt during 2004. Approximately \$1.6 million of this total constitutes unreserved fund balance, which is available for spending at the government's discretion. The remainder of fund balance is reserved to indicate that it is not available for new spending because it has already been committed 1) to fund authorized construction (approximately \$4.6 million) and 2) to pay debt service (approximately \$1.3 million).

The general fund is the chief operating fund of the District. At the end of the current fiscal year, unreserved fund balance of the general fund was approximately \$1.6 million. As a measure of the general fund's liquidity, it may be useful to compare both unreserved fund balance and total fund balance to total fund expenditures.

The fund balance of the District's general fund decreased by a minimal amount (approximately \$3 thousand) during the current fiscal year.

The debt service fund has a total fund balance of approximately \$1.3 million, all of which is reserved for the payment of debt service. The net increase in fund balance during the current year in the debt service fund was approximately \$395 thousand. This increase was related to the proceeds of new long-term debt and the expenditure to refund current debt outstanding.

The capital projects fund has a total fund balance of approximately \$4.6 million, all of which is reserved for authorized construction. The net increase in fund balance during the current year in the capital projects fund (approximately \$4.4 million) related to the issuance of additional long term debt.

### **General Fund Budgetary Highlights**

Differences between the original budget and the final amended budget were due primarily to an increase in certified appraised value for the District. The original budget was based on preliminary assessed values. The increase in revenue amounted to approximately \$176 thousand. This increase was allocated as follows:

- General operating, maintenance and beautification activities – approximately \$63 thousand
- General administrative and operations – approximately \$83 thousand
- Marketing activities – approximately \$19 thousand
- Economic development activities – approximately \$11 thousand

### **Debt Administration**

At the end of the current fiscal year, the District had total debt outstanding of approximately \$15.5 million.

## **Economic Factors and Next Year's Budgets and Rates**

The District is a political subdivision of the State of Texas, created in 1987 by a special act of the 70<sup>th</sup> Texas Legislature. The District levies an ad valorem tax on real in personal property within its boundaries. The tax rate for tax year 2003 was \$0.1435 per \$100 of assessed value. The economic factors affecting Uptown, while encouraging, are difficult to forecast. The tax rate will remain the same for tax year 2004 as for tax year 2003, with expected revenues of approximately \$3 million.

### **Office space**

Uptown has over 23 million square feet of commercial office space. Overall, ad valorem values for the office sector decreased approximately 4% in fiscal year 2004. Over half of the value of this decrease relates to the Williams Tower office building, which currently has over 600,000 square feet of available space. While the office leasing market has taken a hit over the past few years, there are signs of recovery. As of June 30, 2004, Uptown's office market featured the largest quarterly absorption gain compared to Houston's other submarkets (districts). The nearly 212,000 square feet of positive absorption represents the first absorption rate gain in ten consecutive quarters.

### **Retail**

Uptown is synonymous with shopping and is known as a world renowned center for retail. With the new Galleria Foleys/Nordstrom Wing expansion, approximately 700,000 square feet of retail space and parking garages were added to the existing retail center. The lead tenants occupying the space in the expansion are Nordstrom and Foleys, with an additional space for approximately fifty other retailers. The approximate \$100 million expansion was completed in March 2003. Overall, ad valorem values for the retail sector increased approximately 11% in 2004. Most of which can be attributed to the Galleria expansion.

### **Hotel**

There are 26 first-quality, full-service hotels offering more than 6,300 rooms for guest. While the ad valorem values for this sector decreased by approximately 6% from the previous year, the occupancy rate increased by 3.8% and the RevPAR (revenues per available room) increased approximately 11.6% to a rate of \$86.37. Uptown's occupancy rate is 21% higher than Houston's downtown occupancy rate.

### **Residential**

With several new developments, the District's residential market has increased over the past four years. The multi-family (apartment) market had the highest number of units absorbed in the Houston region for the period ending June 30, 2004. With approximately 3,500 multi-family units, average rent for Class A multi-family unit is approximately \$1.18 per square foot and average occupancy stands at approximately 85%.

## **Requests for Information**

This financial report is designed to provide a general overview of the District's finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to 1980 Post Oak Blvd #1580, Houston, TX 77056.

**HARRIS COUNTY IMPROVEMENT DISTRICT # 1**  
**STATEMENT OF NET ASSETS**  
*June 30, 2004*

	<b>Governmental Activities</b>
	<u>                    </u>
<b>ASSETS</b>	
Cash and temporary investments	\$ 7,624,210
Receivables	201,681
Due from other governmental agencies	208,040
Prepaid	30,010
Capital assets, net of depreciation	
Machinery and equipment	6,048,332
Total Capital Assets	<u>6,048,332</u>
Total Assets	<u>14,112,273</u>
<b>LIABILITIES</b>	
Accounts payable and accrued expenses	448,595
Long-term liabilities	
Due within one year	
Bonds	650,000
Accrued interest	372,907
Due in more than one year	
Bonds	14,573,436
Compensated absences	21,761
Total liabilities	<u>16,066,699</u>
<b>NET ASSETS</b>	
Invested in capital assets, net of related debt	(4,513,783)
Restricted for:	
Capital projects	
Debt Service	937,243
Unrestricted	1,622,114
Total net assets	<u>\$ (1,954,426)</u>

*See notes to the Financial Statements*

**HARRIS COUNTY IMPROVEMENT DISTRICT # 1**  
**STATEMENT OF ACTIVITIES**  
*For the Year Ended June 30, 2004*

<u>Functions/Programs</u>	<u>Expenses</u>	<u>Revenue</u> <u>Charges for</u> <u>Services</u>	<u>Net (Expense) Revenue and</u> <u>Changes in Net Assets</u>	
			<u>Governmental</u> <u>Activities</u>	<u>Total</u>
Governmental Activities				
General and administrative	\$ 1,236,929	\$ 517,898	\$ (719,031)	\$ (719,031)
Traffic control	781,991		(781,991)	(781,991)
Maintenance and beautification	973,883		(973,883)	(973,883)
Uptown shuttle	338,359	210,725	(127,634)	(127,634)
Planning and engineering	94,788		(94,788)	(94,788)
Marketing and communications	174,333		(174,333)	(174,333)
Interest on Long-term debt	724,941		(724,941)	(724,941)
Economic development	43,858		(43,858)	(43,858)
Metro	489,145	522,500	33,355	33,355
Construction on behalf of the City of Houston	50,933		(50,933)	(50,933)
Total governmental activities	<u>4,909,160</u>	<u>1,251,123</u>	<u>(3,658,037)</u>	<u>(3,658,037)</u>
<b>General revenues:</b>				
Taxes:				
Property taxes			3,205,621	3,205,621
Unrestricted investment earnings			20,485	20,485
Miscellaneous			171,149	171,149
Total general revenues			<u>3,397,255</u>	<u>3,397,255</u>
Change in net assets			(260,782)	(260,782)
Net assets - beginning			<u>(1,693,644)</u>	<u>(1,693,644)</u>
Net assets - ending			<u>\$ (1,954,426)</u>	<u>\$ (1,954,426)</u>

*See notes to the Financial Statements*

**HARRIS COUNTY IMPROVEMENT DISTRICT # 1**  
**BALANCE SHEET**  
**GOVERNMENTAL FUNDS**  
*June 30, 2004*

	<u>General Fund</u>	<u>Capital Projects</u>	<u>Debt Service</u>	<u>Total Governmental Funds</u>
<b>ASSETS</b>				
Cash and temporary investments	\$ 1,668,211	\$ 4,720,713	\$ 1,235,286	\$ 7,624,210
Taxes receivable, net	79,282		52,947	132,229
Due from other funds		148,522		148,522
Receivable from other governments	208,040			208,040
Due from others	47,534		21,918	69,452
Prepaid expenses	30,009			30,009
Total assets	<u>2,033,076</u>	<u>4,869,235</u>	<u>1,310,151</u>	<u>8,212,462</u>
 <b>LIABILITIES AND FUND BALANCE</b>				
Liabilities:				
Accounts payable	240,680	207,913		448,593
Due to other funds	148,522			148,522
Deferred revenue	79,282		52,947	132,229
Total liabilities	<u>468,484</u>	<u>207,913</u>	<u>52,947</u>	<u>729,344</u>
 Fund balances:				
Reserved for:				
Debt service			1,257,204	1,257,204
Authorized construction		4,661,321		4,661,321
Unreserved	1,564,592			1,564,592
Total fund balances	<u>1,564,592</u>	<u>4,661,321</u>	<u>1,257,204</u>	<u>7,483,117</u>
Total liabilities and fund balances	<u>\$ 2,033,076</u>	<u>\$ 4,869,234</u>	<u>\$ 1,310,151</u>	<u>\$ 8,212,461</u>

*See notes to the Financial Statements*



**HARRIS COUNTY IMPROVEMENT DISTRICT # 1**  
***Reconciliation of the Governmental Funds Balance Sheet to the***  
***Statement of Net Assets***  
***June 30, 2004***

Total fund balance, governmental funds	\$ 7,483,117
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Amounts reported for governmental activities in the Statement of Net Assets are different because:

Capital assets used in governmental activities are not current financial resources and therefore are not reported in this fund financial statement, but are reported in the governmental activities of the Statement of Net Assets	6,048,332
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Certain other receivables are not available to pay current period expenditures and are therefore not reported in this fund financial statement, but are reported in the governmental activities of the Statement of Net Assets	132,230
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Some liabilities are not due and payable in the current period and are not included in the fund financial statements, but are included in the governmental activities of the Statement of Net Assets. These are as follows:

Bonds payable and related discount	(15,223,436)
Accrued interest	(372,908)
Compensated absences	(21,761)
Net Assets of Governmental Activities in the Statement of Net Assets	<u>\$ (1,954,426)</u>

*See notes to the Financial Statements*

**HARRIS COUNTY IMPROVEMENT DISTRICT #1**  
**STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN**  
**FUND BALANCE - GOVERNMENTAL FUNDS**  
**For the Year Ended June 30, 2004**

	<u>General Fund</u>	<u>Capital Projects</u>	<u>Debt Service</u>	<u>Total Governmental Funds</u>
<b>REVENUES</b>				
Property Taxes	\$ 2,183,574	\$	\$ 1,001,028	\$ 3,184,602
Intergovernmental	728,623	675,870		1,404,493
Investment earnings	13,413		7,072	20,485
<b>Total revenues</b>	<u>2,925,610</u>	<u>675,870</u>	<u>1,008,100</u>	<u>4,609,580</u>
<b>EXPENDITURES</b>				
Current:				
Planning and engineering	94,788			94,788
Traffic control	318,151			318,151
Maintenance and beautification	733,484			733,484
General and administrative	1,225,489			1,225,489
Uptown shuttle	338,359			338,359
Marketing and communications	174,333			174,333
Economic development	43,858			43,858
Debt Service:				
Principal			384,990	384,990
Interest and other charges		395,494	357,143	752,637
Capital Outlay		560,869		560,869
<b>Total Expenditures</b>	<u>2,928,462</u>	<u>956,363</u>	<u>742,133</u>	<u>4,626,958</u>
<b>Excess (deficiency) of revenues over expenditures</b>	<u>(2,852)</u>	<u>(280,493)</u>	<u>265,967</u>	<u>(17,378)</u>
<b>OTHER FINANCING SOURCES (USES)</b>				
Proceeds from long-term debt, net		4,705,999	8,908,759	13,614,758
Other use	(72)			(72)
Transfer of debt to escrow agent			(8,779,749)	(8,779,749)
<b>Total other financing sources (uses)</b>	<u>(72)</u>	<u>4,705,999</u>	<u>129,010</u>	<u>4,834,937</u>
<b>Revenue and other financing sources/(uses) over/(under) expenditures</b>	(2,924)	4,425,506	394,977	4,817,559
Fund balances - beginning of year, as restated	1,567,516	235,815	862,227	2,665,558
<b>Fund balances - End of Year</b>	<u>\$ 1,564,592</u>	<u>\$ 4,661,321</u>	<u>\$ 1,257,204</u>	<u>\$ 7,483,117</u>

See notes to the Financial Statements

**HARRIS COUNTY IMPROVEMENT DISTRICT # 1**

***Reconciliation of the Statement of Revenues, Expenditures, and Changes in Fund Balances of Governmental Funds to the Statement of Activities  
For the Year Ended June 30, 2004***

Net change in fund balances - total governmental funds: \$ 4,817,559

Amounts reported for Governmental Activities in the Statement of Activities are different because:

Governmental funds report outlays for capital assets as expenditures because such outlays use current financial resources. In contrast, the Statement of Activities reports only a portion of the outlay as expense. The outlay is allocated over the assets' estimated useful lives as depreciation expense for the period.

This is the amount by which depreciation of \$704,239 exceeded capital outlay of \$20,791 (683,448)

Governmental funds do not report revenues that are not available to pay current obligations. In contrast, such revenue is reported in the Statement of Activities when earned.

Property taxes 21,019

Governmental funds report bond proceeds as current financial resources. In contrast, the Statement of Activities treats the issuance of debt as a liability. Governmental funds report bond principal payments as an expenditures. In contrast, the Statement of Activities treats such expenditures as a reduction of long-term liabilities. This is the amount by which proceeds exceeded repayments, issuance costs and deferred amounts:

Principal repayments	375,000
Payment to refunding agent	8,779,750
Bond proceeds	(13,596,979)
Deferred amounts	(13,579)

Some expenses reported in the statement of activities do not require the use of current financial resources and are not reported as expenditures in governmental funds. These are as follows:

Accrued interest not reflected on Governmental funds	41,274
Compensated absences	(1,378)

Change in net assets of governmental activities \$ (260,782)

*See notes to the Financial Statements*

**HARRIS COUNTY IMPROVEMENT DISTRICT**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**June 30, 2004**

**NOTE 1 - CREATION OF DISTRICT**

Harris County Improvement District No. 1 (the District) was organized, created, and established pursuant to an act of the Texas State Legislature, effective under the terms and provisions of Article III, Section 52 and Article XVI, Section 59 of the Texas Constitution. The Board of Directors held its organizational meeting on July 18, 1987. The first bonds were sold on June 23, 1993. See Note 7 for additional disclosure regarding significant legal provisions contained in the legislative act creating the District.

**NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The financial statements of the District have been prepared in conformity with generally accepted accounting principles (GAAP) as applied to governmental units. The Government Accounting Standards Board (GASB) is the accepted standard setting body for establishing governmental accounting and reporting principles. The more significant of the government's accounting policies are described below.

**A. Reporting Entity**

The District is a political subdivision of the State of Texas, governed by an appointed board, and is considered a primary government. As required by accounting principles generally accepted in the United States of America, these general purpose financial statements have been prepared, based on considerations regarding the potential for inclusion of other entities, organizations, or functions, as part of the District's financial reporting entity. Based on these considerations, no other entities, organizations, or functions have been included in the District's financial reporting entity. Additionally, as the District is considered a primary government for financial reporting purposes, its activities are not considered a part of any other governmental or other type of reporting entity.

Considerations regarding the potential for inclusion of other entities, organizations, or functions in the District's financial reporting entity are based on criteria prescribed by accounting principles generally accepted in the United States of America. These same criteria are evaluated in considering whether the District is a part of any other governmental or other type of reporting entity. The overriding elements associated with prescribed criteria considered in determining that the District's financial reporting entity status is that of a primary government are; that it has a separately elected governing body; it is legally separate; and it is fiscally independent of other state and local governments. Although not considered significant in the District's reporting entity evaluation, other prescribed criteria under accounting principles generally accepted in the United States of America include considerations pertaining to organizations for which the primary government is financially accountable; and, considerations pertaining to other organizations for which the nature and significance of their relationship with the primary government are such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete.

The District's primary activities include managing and financing improvement projects and/or services benefiting the District. These activities include maintenance and beautification of the area, traffic control and transportation projects, special events for the holiday seasons, general planning and engineering, area marketing, major capital improvements, and general and administrative services.

**HARRIS COUNTY IMPROVEMENT DISTRICT**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**June 30, 2004**

**NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**B. Government-Wide and Fund Financial Statements**

The Government-wide financial statements (i.e. the Statement of Net Assets and the Statement of Activities) report information about the District as a whole. For the most part, the effect of interfund activity has been removed from these statements.

The Statement of Activities demonstrates the degree to which the direct expenses of a given function or segment is offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenue includes 1) charges to customers or applicants, who purchase, use or directly benefit from goods, services or privileges provided by a given function or segment and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular segment. Taxes and other items not properly included among program revenues are reported as general revenues.

**C. Measurement Focus, Basis of Accounting and Financial Statement Presentation**

The Government-wide financial statements are reported using the *economic resources measurement focus* and the *accrual basis of accounting*. Revenues are recognized when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

GASB Statement No. 34 established standards for external financial reporting for all state and local governmental entities, which includes a statement of net assets and a statement of activities. It requires the reclassification of net assets into three components – invested in capital assets, net of related debt; restricted; and unrestricted. These classifications are as follows:

- Invested in capital assets, net of related debt – This component of net assets consists of capital assets, including restricted capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, notes or other borrowings.
- Restricted – This component of net assets consists of constraints placed on net asset use through external constraints imposed by creditors, grantors, contributors, or laws or regulations of other governments or constraints imposed by law through contractual provisions or enabling legislation.
- Unrestricted net assets – This component of net assets consists of net assets that do not meet the definition of “restricted” or “invested in capital assets, net of related debt.”

Governmental fund financial statements are reported using the *current financial resources measurement focus* and the *modified accrual basis of accounting*. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available if they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose the Authority considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures are generally recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

**HARRIS COUNTY IMPROVEMENT DISTRICT**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**June 30, 2004**

**NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

The District reports the following major governmental funds:

The *General Fund* is used to account for administrative operations of the District. The principal source of revenue is property taxes. Expenditures include all costs associated with the daily operations of the authority.

The *Debt Service Fund* is used to account for the payment of interest and principal on all general long-term debt of the District. The primary source of revenue is provided by contract tax increment revenue.

The *Capital Projects Fund* is used to account for the expenditure of bond proceeds used in the construction of authorized improvement projects.

**D. Cash and Temporary Investments**

The District's cash and temporary investments consist of demand deposits and money market accounts. Money market accounts are stated at cost, which approximates their fair value.

**E. Bond Discounts**

In governmental fund types, bond discounts are recognized in the current period and are deferred and amortized in the Government-wide Statement of Activities.

**F. Use of Estimates**

The preparation of financial statements, in conformity with generally accepted accounting principles, requires management to make estimates and assumptions that affect the amounts reported in the financial statements. Actual results could differ from those estimates.

**G. Fund Equity**

In the fund financial statements the District reserves or designates all or portions of fund equity in the various governmental fund financial statements. The unreserved fund balances for governmental funds represent the amount available for budgeting future operations. The reserved fund balances for governmental funds represent the amount that has been legally identified for specific purposes.

**H. Budget**

A non-appropriated budget is adopted for the General Fund. The budget is prepared using the same method of accounting as for financial reporting. Encumbrance accounting is not utilized.

**I. Compensated Absences**

The District's employees earn vacation leave, which may either be taken or accumulated, up to certain amounts, until paid upon termination or retirement. The amounts are recorded as a liability on the Statement of Net Assets.

**HARRIS COUNTY IMPROVEMENT DISTRICT**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**June 30, 2004**

**NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**J. Capital Assets**

Capital assets are reported in the governmental activities column in the government-wide financial statements. The District defines capital assets with an initial, individual cost of \$5,000 and an estimated useful life in excess of one year. All purchased capital assets are valued at cost where historical records exist. Donated capital assets are valued at their estimated fair value on the date received. Assets are depreciated over their remaining useful lives using the straight line method.

<u>Asset</u>	<u>Estimated Useful Lives</u>
Machinery and Equipment	5 – 20 years

**NOTE 3 - CASH AND TEMPORARY INVESTMENTS**

**Investment Policies**

Applicable statutes allow the District to invest its funds in direct or indirect obligations of the United States, the State, or any county, city, school district, or other political subdivision of the State. Funds may also be placed in certificates of deposit of the State or national banks or savings and loan associations (depository institutions). Related state statutes and provisions included in the District's bond resolutions require that all funds invested in depository institutions be covered by federal depository insurance and/or be secured in the manner provided by law for the security of public funds.

The District's governing board and administration have enacted policies to ensure compliance with state laws regarding deposit of District funds and maintain a formal depository agreement with their depository bank. The depository agreement provides for proper collateralization of funds, in accordance with state and federal statutes.

At year end, the carrying value of the District's cash and temporary investments (which approximates market value) was as follows:

	<b>Carrying Value</b>
Demand and time deposits	\$ 7,624,210
	\$ 7,624,210

Collateral is required for all bank deposits at 100% of deposits not covered by federal depository insurance. The Authority's deposits at year end were entirely covered by federal depository insurance or by acceptable collateral held by the District's agent in the District's name.

**NOTE 4 – INTERFUND TRANSACTIONS**

As of June 30, 2004 the General Fund owed the Capital Projects Fund \$148,522. This interfund receivable is considered to be a temporary loan and will be repaid during the following fiscal year.

**HARRIS COUNTY IMPROVEMENT DISTRICT**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**June 30, 2004**

**NOTE 5 – RECEIVABLES**

Amounts recorded as receivables as of September 30, 2003 for the government’s major funds, including the applicable allowance for uncollectible accounts, are as follows:

	<u>General</u>	<u>Debt Service</u>	<u>Total</u>
Receivables:			
Taxes	\$ 79,282	\$ 52,947	\$ 132,229
Other	47,534	21,918	69,452
	<u>\$ 126,816</u>	<u>\$ 74,865</u>	<u>\$ 201,681</u>

Allowance for doubtful accounts is considered to be immaterial and has not been recorded in the financial statements.

**NOTE 6 – PROPERTY TAXES**

On May 30, 1992, the voters of the District authorized the District's Board of Directors to levy taxes annually for use in financing general operations (maintenance tax) limited to \$0.25 per \$100 of assessed property valuation. The Harris County Central Appraisal District, if any, determines all property valuations and exempt status. The District's bond resolution requires that property taxes be levied for use in paying interest and principal on long-term debt and for use in paying costs incurred in assessment and collection of these taxes. Taxes levied for debt service and related costs are without limitation as to rate or amount.

The District has contracted with the Harris County Tax Assessor/Collector for its tax levy and collection functions. A tax lien attaches to properties within the District on January 1st of each year when property valuations for use in levying taxes are established. Taxes levied are generally billed in October and are due upon receipt of the tax bill. Penalty and interest are charged if taxes are not paid by January 31st. There is an additional fifteen percent penalty charged on accounts delinquent after July 1<sup>st</sup>, which generally is payable to the District's delinquent tax attorney.

For the current year, the District levied property taxes of \$0.1435 per \$100 of assessed valuation of which \$0.0985 was allocated to general operations and \$0.045 was allocated to debt service. The total tax levy was approximately \$3.1 million based on an adjusted taxable property valuation of approximately \$2.2 million for the 2003 tax year. The total tax levy was allocated to general operations and debt service in the amounts of \$2,154,565 and \$984,319, respectively.



**HARRIS COUNTY IMPROVEMENT DISTRICT**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**June 30, 2004**

**NOTE 6 – PROPERTY TAXES (continued)**

Taxes receivable at June 30, 2004, consist of the following:

<u>Tax Year</u>	<u>General</u>	<u>Debt Service</u>	<u>Totals</u>
2003	\$ 22,637	\$ 15,538	\$ 38,175
2002	9,358	6,326	15,684
2001	8,616	4,026	12,642
2000	8,969	4,452	13,421
1999	5,065	2,359	7,424
1998	3,786	1,933	5,719
1997	3,726	2,315	6,041
1996	3,839	3,609	7,448
1995	5,793	4,864	10,657
1994	5,678	4,036	9,714
1993	1,815	3,489	5,304
	<u>\$ 79,282</u>	<u>\$ 52,947</u>	<u>\$ 132,229</u>

**NOTE 7 – CAPITAL ASSETS**

A summary of activity for capital assets capitalized by the District for the year ended June 30, 2004 follows:

	<u>Balance July 1, 2003</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance June 30, 2004</u>
<b>Governmental Activities</b>				
Capital assets being depreciated:				
Machinery and equipment	\$ 12,939,968	\$ 20,791	\$	\$ 12,960,759
Total capital assets being depreciated	12,939,968	20,791		12,960,759
Less accumulated depreciation for:				
Machinery and equipment	(6,208,188)	(704,239)		(6,912,427)
Governmental activities capital assets, net	<u>\$ 6,731,780</u>	<u>\$ (683,448)</u>	<u>\$</u>	<u>\$ 6,048,332</u>

Depreciation was charged to functions of the District as follows:

<b>Governmental activities:</b>	
Traffic control	\$ 658,704
Marketing and communications	45,535
	<u>\$ 704,239</u>

**HARRIS COUNTY IMPROVEMENT DISTRICT**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**June 30, 2004**

**NOTE 8 – LONG TERM DEBT**

Payment of principal and interest on the bonds is to be provided from tax levies on properties within the District. As the bonds are unlimited tax bonds, no other funds of the District have been pledged for debt service requirements. Investment income realized by the Debt Service Fund, from investment of excess funds, will be used to pay outstanding bond principal and interest.

During the year ended June 30, 2004, the following changes occurred in long-term liabilities:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Due within One year</u>	<u>Deferred Costs</u>
<b>Governmental Activities</b>						
Unlimited tax bonds	\$ 10,790,000	\$ 13,635,000	\$ (8,930,000)	\$ 15,495,000	\$ 650,000	\$ 271,564
Compensated absences	20,383	36,813	(35,436)	21,760		
	<u>\$ 10,810,383</u>	<u>\$ 13,671,813</u>	<u>\$ (8,965,436)</u>	<u>\$ 15,516,760</u>	<u>\$ 650,000</u>	<u>\$ 271,564</u>

The District incurred and expensed total interest of \$356,206, all of which was interest on long-term debt.

Annual debt service requirements to retire outstanding unlimited tax bonds are as follows:

<u>Year Ending June 30,</u>	<u>Governmental Activities</u>		
	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2005	\$ 650,000	\$ 381,599	\$ 1,031,599
2006	525,000	563,323	1,088,323
2007	535,000	550,073	1,085,073
2008	545,000	536,448	1,081,448
2009	565,000	522,779	1,087,779
2010	590,000	508,910	1,098,910
2011	610,000	493,433	1,103,433
2012	640,000	475,713	1,115,713
2013	675,000	455,900	1,130,900
2014	705,000	433,123	1,138,123
2015	745,000	408,600	1,153,600
2016	785,000	381,216	1,166,216
2017	830,000	351,557	1,181,557
2018	875,000	318,615	1,193,615
2019	920,000	282,806	1,202,806
2020	965,000	243,968	1,208,968
2021	1,015,000	203,008	1,218,008
2022	1,060,000	158,816	1,218,816
2023	1,105,000	111,348	1,216,348
2024	1,155,000	54,553	1,209,553
	<u>\$ 15,495,000</u>	<u>\$ 7,435,785</u>	<u>\$ 22,930,785</u>

**HARRIS COUNTY IMPROVEMENT DISTRICT**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**June 30, 2004**

**NOTE 8 – LONG TERM DEBT (continued)**

The following is a summary of the terms of obligations of unlimited tax bonds outstanding as of June 30, 2004:

<b>Governmental Activities</b>			Debt	Unamortized
<u>Series</u>	<u>Original Issue</u>	<u>Interest Rate</u>	<u>Outstanding</u>	<u>Bond Issuance</u>
				<u>Cost</u>
Unlimited Tax Bonds, Series 1999	\$ 2,000,000	5.00%-7.00%	\$ 1,860,000	\$
Unlimited Tax Improvement and Refunding Bonds, Series 2004	13,635,000	2.00%-5.00%	<u>13,635,000</u>	<u>271,564</u>
<b>Total Governmental Activities</b>			<u><u>\$ 15,495,000</u></u>	<u><u>\$ 271,564</u></u>

A summary of District Bonds authorized but unissued at June 30, 2004 follows:

<u>Purpose</u>	<u>Date</u>	<u>Amount</u>	<u>Amount</u>
	<u>Authorized</u>	<u>Authorized</u>	<u>Unissued</u>
Stimulation and development of transportation	05/30/92	\$ 75,000,000	\$ 59,915,000
Conservation and preservation of natural resources	05/30/92	25,000,000	22,005,000
Improvement projects payable from assessments	05/30/92	25,000,000	25,000,000
Improvement projects for economic diversification	11/20/93	<u>25,000,000</u>	<u>25,000,000</u>
		<u><u>\$ 150,000,000</u></u>	<u><u>\$ 131,920,000</u></u>

The District is in compliance with all significant requirements and restrictions contained in its bond resolution.

**Current Year Refunding of Long-Term Debt**

During the year the District issued Unlimited Tax Improvement and Refunding Bonds, Series 2004 to advance refund the remaining outstanding Unlimited Tax Bonds, Series 1993. As a result, the refunded bonds are considered defeased and the liability has been removed from the government-wide financial statements. The reacquisition price exceeded the net carrying amount of the old debt by \$224,749. This amount is being netted against the new debt and amortized over the remaining life of the refunded debt. This advance refunding was undertaken to reduce total debt service payments over the next twenty one years by \$1,200,336 and resulted in an economic gain of \$885,838.

**HARRIS COUNTY IMPROVEMENT DISTRICT**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**June 30, 2004**

**NOTE 9 - SIGNIFICANT LEGAL PROVISIONS OF LEGISLATIVE ACT CREATING THE DISTRICT**

As discussed in Note 1 above, the District has been established pursuant to an act of the Texas State Legislature. Significant legal provisions of this act are summarized below.

**A. District Boundaries**

The act provides specifically for boundaries of the District, which includes the Uptown Houston area. The Uptown Houston area is also known as the Galleria-Post Oak area in Houston, Texas. The District may annex additional land area in accordance with Chapter 54 of the Texas Water Code.

**B. Texas Commission on Environmental Quality Involvement**

The act provides that the Texas Commission on Environmental Quality is to appoint District Directors. The Directors are to serve staggered four-year terms. Additionally, the Texas Commission on Environmental Quality must approve the issuance of any bonded indebtedness for the purposes of providing water, sewer, or drainage facilities within the District. No other District activities are subject to the jurisdiction of the Texas Commission on Environmental Quality.

**C. General and Specific Powers of the District**

The act provides general powers to the District subject to general laws and regulations of the state applicable to conservation and reclamation districts created under Article XVI, Section 59 of the Texas Constitution and road districts and road utility districts created pursuant to Article III, Section 52, of the Texas Constitution, including those conferred by Chapter 54 of the Water Code and Chapter 13, Acts of the 68th legislature, 2nd Called Session, 1984 (Article 6674r-1, Vernon's Texas Civil Statutes).

Additional specific powers and duties are provided for in the act, which include the financing of improvement projects and/or services for the benefit of the District. Specific types of improvement projects are provided for in the act and include the acquisition of land in connection with the improvements. Eminent domain powers are specifically prohibited by the act. Improvement projects and/or services may be financed in whole or in part by the levy and collection of special assessments or property taxes on property in the area. The act also provides that maintenance taxes may be levied after voter approval.

The act provides for the method by which the District must petition, provide notice, and hold public hearings prior to the financing of the improvement projects and/or services.

The act also provides for the issuance of voter approved bonded indebtedness to finance improvement projects and/or services. Specific guidelines in the act provide for the repayment of bonds, which might be issued, as well as the use of bond proceeds, available security that can be pledged in issuing the bonds, and refunding capabilities for outstanding bonds.

**D. Director Bonds**

The act requires that each Director appointed execute a bond for \$10,000 payable to the District and conditioned on faithful performance of his or her duties. All bonds of the Directors shall be approved by the Board.

**HARRIS COUNTY IMPROVEMENT DISTRICT**  
**NOTES TO THE FINANCIAL STATEMENTS**  
*June 30, 2004*

**NOTE 9 - SIGNIFICANT LEGAL PROVISIONS OF LEGISLATIVE ACT CREATING THE DISTRICT (continued)**

**E. Other Provisions**

Other significant provisions of the act include City of Houston approval requirements for issuance of bonds for all improvement projects, bonded indebtedness limits, contracting powers, dissolution procedures, director qualifications, and procedural requirements regarding Board meetings and District business matters.

**NOTE 10 - OPERATING AGREEMENT - UPTOWN HOUSTON ASSOCIATION**

The District has entered into an operating agreement with Uptown Houston Association (the Association). The Association is a non-profit corporation formed to carry on maintenance and improvements in the Uptown Houston area. The governing boards of both the District and the Association have common members. It is the intent of both governing boards to maintain separately controlled operating entities. The agreement calls for the District to perform many of the functions previously performed by the Association, primarily the maintenance, enhancement, and marketing of the Uptown Houston area. Additionally, the Association has granted the District the use of Association assets without charge to the District. A summary of the Association's financial position as of March 31, 2003, is as follows:

UPTOWN HOUSTON ASSOCIATION  
MARCH 31, 2004

Current and other assets	\$ 27,425
<b>Total Assets</b>	<u>27,425</u>
Net assets:	
Unrestricted	27,425
<b>Total Net Assets</b>	<u>\$ 27,425</u>

**NOTE 11 - PENSION PLAN**

For the benefit of its employees, the District provides discretionary contributions to a simplified employee pension plan, meeting the requirements of Internal Revenue Code Section 408(k). For the year ended June 30, 2004, the District contributed \$53,584 to the plan.

**NOTE 12 - RISK MANAGEMENT**

The District is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; personal injuries; and natural disasters. The risk of loss is covered by commercial insurance. There have been no significant reductions in insurance coverage. Settlement amounts have not exceeded insurance coverage for current year or the three prior years.

**NOTE 13 - TAX INCREMENT REINVESTMENT ZONE**

During the current and prior years, the District incurred certain planning expenditures related to the creation of Tax Increment Reinvestment Zone No. 16 of the City of Houston (TIRZ). The TIRZ is located on property generally within the District's service area. During the year ended June 30, 2004, the District received approximately \$535,000 from the TIRZ for reimbursement of administration costs, project management costs, and traffic and mobility costs.

**HARRIS COUNTY IMPROVEMENT DISTRICT**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**June 30, 2004**

**NOTE 14 – CONTRACTUAL COMMITMENTS**

In October 2002, the District entered into a contract with the Houston-Galveston Area council (HGAC) for a transit pilot project to provide convenient and frequent daytime internal transit service to add mobility alternatives for Uptown workers and residents. As of September 30, 2004, shuttle operations ceased and the contract terminated due to low ridership and Metros recent elimination of three direct bus routes to the area, which also negatively affected ridership.

**NOTE 15 – RESTATEMENT OF FUND BALANCE**

As a result of implementing new accounting and reporting standards in the current year, the District has restated fund balance in the General Fund at the beginning of the year (July 1, 2003) to remove the District’s accrued compensated absences fund liability. In the past the District has considered the entire accrued compensated absences liability a fund liability.

As a result of amending the District’s procedures related to the capitalization level for capital assets, the District has restated beginning capital asset balances to remove assets below the amended level from the District’s financial statements.

The restatements listed above are shown below:

Beginning capital assets, as originally reported	\$ 13,569,341
Adjustment to remove capital assets with values below the amended capitalization level	<u>(629,373)</u>
Beginning capital assets, as restated	<u><u>\$ 12,939,968</u></u>
	<b><u>General Fund</u></b>
Beginning fund balance, as originally reported	\$ 1,547,133
Adjustment to remove the Districts accrued compensated absences fund liability	<u>20,383</u>
Beginning fund balance, as restated	<u><u>\$ 1,567,516</u></u>

**REQUIRED SUPPLEMENTARY INFORMATION**

**HARRIS COUNTY IMPROVEMENT DISTRICT #1**  
**GENERAL FUND**  
**SCHEDULE OF REVENUES, EXPENDITURES AND**  
**CHANGES IN FUND BALANCE - BUDGET AND ACTUAL**  
**For the Year Ended June 30, 2004**

	<u>Budgeted Amounts</u>		<u>Actual</u>	<u>Variance with Final Budget Positive / (Negative)</u>
	<u>Original</u>	<u>Final</u>		
<b>REVENUES</b>				
Property Taxes	\$ 1,947,482	\$ 2,123,800	\$ 2,183,574	\$ 59,774
Intergovernmental	530,000	535,200	517,898	(17,302)
Shuttle program			210,725	210,725
Investment earnings	23,583	18,193	13,413	(4,780)
<b>Total revenues</b>	<u>2,501,065</u>	<u>2,677,193</u>	<u>2,925,610</u>	<u>248,417</u>
<b>EXPENDITURES</b>				
Current:				
Planning and engineering	75,000	75,000	94,788	(19,788)
Traffic control	345,000	345,000	318,151	26,849
Maintenance and beautification	663,500	726,500	733,484	(6,984)
General and administrative	1,118,465	1,201,265	1,225,489	(24,224)
Uptown shuttle	100,000	100,000	338,359	(238,359)
Marketing and communications	168,000	186,928	174,333	12,595
Economic development	31,100	42,500	43,858	(1,358)
<b>Total Expenditures</b>	<u>2,501,065</u>	<u>2,677,193</u>	<u>2,928,462</u>	<u>(251,269)</u>
<b>Excess (deficiency) of revenues over expenditures</b>			<u>(2,852)</u>	<u>(2,852)</u>
<b>OTHER FINANCING SOURCES (USES)</b>				
Other source			(72)	(72)
<b>Total other financing sources (uses)</b>			<u>(72)</u>	<u>(72)</u>
<b>Revenue and other financing sources/(uses) over/(under) expenditures</b>			(2,924)	(2,924)
Fund balances - beginning of year, as restated	1,567,516	1,567,516	1,567,516	
<b>Fund balances - End of Year</b>	<u>\$ 1,567,516</u>	<u>\$ 1,567,516</u>	<u>\$ 1,564,592</u>	<u>\$ (2,924)</u>