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HARRIS COUNTY
IMPROVEMENT DISTRICT NO. 1

HOUSTON, TEXAS

FINANCIAL REPORT

June 30, 2003

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DRAFT

Independent Auditors' Report

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

We have audited the accompanying general purpose financial statements of Harris County Improvement District No. 1, as of June 30, 2003, and for the year then ended, as listed in the table of contents. These general purpose financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these general purpose financial statements based on our audit.

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

In our opinion, the general purpose financial statements referred to above present fairly, in all material respects, the financial position of the Harris County Improvement District No. 1, as of June 30, 2003, and the results of its operations for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

Houston, Texas
October 10, 2003

GENERAL PURPOSE FINANCIAL STATEMENTS

HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

**COMBINED BALANCE SHEET -
ALL FUND TYPES AND ACCOUNT GROUPS**

June 30, 2003

	Governmental Fund Types		
	General	Debt Service	Capital Projects
<u>Assets and Other Debits</u>			
<u>Assets</u>			
Cash and temporary investments	\$ 1,121,905	\$ 840,309	\$ 120,701
Property taxes receivable	67,040	44,170	
Due from TIRZ	701,541		125,227
Due from HGAC	49,928		
Due from others	67,816	21,918	
Due from other funds			200,000
Prepaid expenditures	9,163		
Physical facilities			
District organizational costs			
<u>Other Debits</u>			
Amount available in debt service fund			
Amount to be provided for retirement of general long-term debt			
Total Assets and Other Debits	<u>\$ 2,017,393</u>	<u>\$ 906,397</u>	<u>\$ 445,928</u>
<u>Liabilities, Equity, and Other Credits</u>			
<u>Liabilities</u>			
Accounts payable	\$ 182,837	\$	\$ 210,113
Due to other funds	200,000		
Accrued compensated absences	20,383		
Deferred revenue	67,040	44,170	
Bonds payable			
Total Liabilities	<u>470,260</u>	<u>44,170</u>	<u>210,113</u>
<u>Equity and Other Credits</u>			
Investment in general fixed assets			
Fund Balances:			
Reserved for debt service		862,227	
Unreserved:			
Designated for authorized capital projects			235,815
Undesignated	1,547,133		
Total Equity and Other Credits	<u>1,547,133</u>	<u>862,227</u>	<u>235,815</u>
Total Liabilities, Equity, and Other Credits	<u>\$ 2,017,393</u>	<u>\$ 906,397</u>	<u>\$ 445,928</u>

See Notes to Financial Statements.

Account Groups		Totals (Memorandum Only)	
General Fixed Assets	General Long- Term Debt	June 30, 2003	June 30, 2002
\$	\$	\$ 2,082,915	\$ 3,110,640
		111,210	94,890
		826,768	219,878
		49,928	
		89,734	
		200,000	
		9,163	
13,066,175		13,066,175	12,787,527
503,166		503,166	503,166
	862,227	862,227	856,288
	9,927,773	9,927,773	10,278,712
<u>\$ 13,569,341</u>	<u>\$ 10,790,000</u>	<u>\$ 27,729,059</u>	<u>\$ 27,851,101</u>
\$	\$	\$ 392,950	\$ 431,510
		200,000	
		20,383	15,106
		111,210	94,890
	10,790,000	10,790,000	11,135,000
	<u>10,790,000</u>	<u>11,514,543</u>	<u>11,676,506</u>
13,569,341		13,569,341	13,290,693
		862,227	856,288
		235,815	506,307
		1,547,133	1,521,307
<u>13,569,341</u>		<u>16,214,516</u>	<u>16,174,595</u>
<u>\$ 13,569,341</u>	<u>\$ 10,790,000</u>	<u>\$ 27,729,059</u>	<u>\$ 27,851,101</u>

HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

COMBINED STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES - ALL GOVERNMENTAL FUND TYPES

Year Ended June 30, 2003

	<u>Governmental Fund Types</u>		
	<u>General</u>	<u>Debt Service</u>	<u>Capital Projects</u>
<u>Revenues</u>			
Property taxes	\$ 2,017,241	\$ 969,442	\$
Interest income	20,653	9,658	6,492
Other			
Total Revenues	<u>2,037,894</u>	<u>979,100</u>	<u>6,492</u>
<u>Expenditures</u>			
Current:			
Maintenance and beautification	590,383		
Traffic control	397,002		
Planning and engineering	108,013		
Marketing and communications	255,263		
General and administrative	1,273,031	9,825	36
Shuttle	126,596		
Capital Outlay	1,700		276,948
Debt Service:			
Principal		345,000	
Interest and fiscal charges		618,336	
Total Expenditures	<u>2,751,988</u>	<u>973,161</u>	<u>276,984</u>
Revenues Over (Under) Expenditures	<u>(714,094)</u>	<u>5,939</u>	<u>(270,492)</u>
<u>Other Financing Sources (Uses)</u>			
Reimbursement from TIRZ	<u>739,920</u>		
Total Other Financing Sources	<u>739,920</u>		
Revenues and Other Financing Sources Over (Under) Expenditures and Other Financing (Uses)	<u>25,826</u>	<u>5,939</u>	<u>(270,492)</u>
Fund Balances - Beginning	<u>1,521,307</u>	<u>856,288</u>	<u>506,307</u>
Fund Balances - Ending	<u>\$ 1,547,133</u>	<u>\$ 862,227</u>	<u>\$ 235,815</u>

See Notes to Financial Statements.

Totals
(Memorandum Only)

June 30, 2003	June 30, 2002
\$ 2,986,683	\$ 3,085,615
36,803	79,818
3,023,486	13,426
3,023,486	3,178,859
590,383	709,657
397,002	343,990
108,013	196,782
255,263	961,610
1,282,892	1,124,881
126,596	
278,648	637,306
345,000	335,000
618,336	641,445
4,002,133	4,950,671
(978,647)	(1,771,812)
739,920	615,815
739,920	615,815
(238,727)	(1,155,997)
2,883,902	4,039,899
<u>\$ 2,645,175</u>	<u>\$ 2,883,902</u>

HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE - BUDGET AND ACTUAL - GENERAL FUND

Year Ended June 30, 2003
with comparative actual amounts for the Year Ended June 30, 2002

	<u>2003</u>		<u>Variance</u>	<u>2002</u>
	<u>Budget</u>	<u>Actual</u>	<u>Favorable</u> <u>(Unfavorable)</u>	<u>Actual</u>
Revenues				
Property taxes	\$ 2,186,688	\$ 2,017,241	\$ (169,447)	\$ 2,110,159
Interest income	55,000	20,653	(34,347)	45,244
Other			-	12,414
Total Revenues	<u>2,241,688</u>	<u>2,037,894</u>	<u>(203,794)</u>	<u>2,167,817</u>
Expenditures				
Current:				
Maintenance and beautification	723,188	590,383	132,805	709,657
Traffic control	345,000	397,002	(52,002)	343,990
Planning and engineering	125,000	108,013	16,987	196,782
Marketing and communications	245,000	255,263	(10,263)	961,610
General and administrative	1,185,500	1,273,031	(87,531)	1,124,881
Shuttle	100,000	126,596	(26,596)	
Capital Outlay	<u>13,000</u>	<u>1,700</u>	<u>11,300</u>	<u>40,202</u>
Total Expenditures	<u>2,736,688</u>	<u>2,751,988</u>	<u>(15,300)</u>	<u>3,377,122</u>
Revenues (Under)				
Expenditures	(495,000)	(714,094)	(219,094)	(1,209,305)
Other Financing Sources (Uses)				
Interfund transfers				(86,000)
Reimbursement from TIRZ	495,000	739,920	244,920	615,815
Total Other Financing Sources	<u>495,000</u>	<u>739,920</u>	<u>244,920</u>	<u>529,815</u>
Revenues and Other Financing Sources Over (Under) Expenditures and Other Financing (Uses)		25,826	25,826	(679,490)
Fund Balance - Beginning	<u>1,521,307</u>	<u>1,521,307</u>		<u>2,200,797</u>
Fund Balance - Ending	<u>\$ 1,521,307</u>	<u>\$ 1,547,133</u>	<u>\$ 25,826</u>	<u>\$ 1,521,307</u>

See Notes to Financial Statements.

HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

NOTES TO FINANCIAL STATEMENTS

June 30, 2003

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 accounting policies of the District conform with accounting principles generally accepted in the United States of America. The following is a summary of the most significant policies.

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.

B. Fund Accounting

The accounts of the District are organized on the basis of funds and account groups, each of which is considered to be a separate accounting entity. The operations of each fund are accounted for by providing a separate set of self-balancing accounts, which comprise its assets, liabilities, fund equity, revenues, and expenditures. The following is a description of the various funds and account groups:

HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

NOTES TO FINANCIAL STATEMENTS

June 30, 2003

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Governmental Fund Types

General Fund

The General Fund is used to account for the operations of the District and all other financial transactions not properly includable in other funds. The principal source of revenue is provided by property taxes assessed to and paid by property owners within the District. Expenditures include all costs associated with the District's operating activities.

Debt Service Fund

The Debt Service Fund is used to account for the payment of interest and principal on the District's general long-term debt. The primary source of revenue for debt service is property taxes levied pursuant to requirements of the District's bond resolution. Expenditures include costs incurred in assessing and collecting these taxes.

Capital Projects Fund

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

Account Groups

General Fixed Assets Account Group

Fixed assets purchased by the District are shown at original cost. Costs related to the organization of the District are also included. Costs associated with fixed asset purchases and District organization are recorded as expenditures in the General and Capital Projects Funds; and, are capitalized in the General Fixed Assets Account Group. No depreciation has been provided on general fixed assets. The District's asset capitalization policies include capitalization for infrastructure assets.

General Long-Term Debt Account Group

This account group is used to account for the District's bonds.

C. Basis of Accounting

Revenues and expenditures are recognized under the modified accrual basis of accounting. Revenues are recognized in the accounting period in which they become both available and measurable (see discussion below regarding property taxes). Expenditures are recognized in the accounting period in which the liability is incurred, if measurable, except for unmatured interest on general long-term debt, which is recognized when due.

Property tax revenues are generally recognized in the period for which the tax levy was made. Property taxes receivable at the end of the fiscal year are treated as deferred revenue because they are not considered available to pay liabilities of the current period.

D. 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.

HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

NOTES TO FINANCIAL STATEMENTS

June 30, 2003

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

E. Cash and Temporary Investments

Cash and temporary investments consist of interest bearing money market accounts. Money market accounts are stated at cost, which approximates their fair value.

F. 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 of the General Fund.

G. Short-Term Interfund Receivables/Payables

During the course of operations, transactions occur between individual funds for making expenditures. These receivables and payables are classified as due from other funds or due to other funds on the balance sheet.

H. Fund Equity

Reserved equity balances represent those portions of fund balance not appropriable for expenditure or legally segregated for a specific future use. Designated fund balances represent tentative plans for future use of financial resources. Undesignated fund balances represent available balances for the District's future use.

I. Total Columns on Combined Statement

Total columns on the combined statements are captioned "(Memorandum Only)" to indicate that they are presented only to facilitate financial analysis. Data in these columns do not present financial position or results of operations in conformity with accounting principles generally accepted in the United States of America. Interfund eliminations have not been made in the aggregation of this data.

J. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America, 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 reporting period. Actual results could differ from those estimates.

HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

NOTES TO FINANCIAL STATEMENTS

June 30, 2003

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. Balances in the District's depository accounts were not entirely covered by federal depository insurance, or security, as provided by statutes and bond resolutions at June 30, 2003.

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.

Cash and temporary investments consist of money market accounts. Cash and temporary investments in the Debt Service Fund of \$840,309 is restricted for use in paying interest and principal on general long-term debt, paying agent fees, and costs of assessing and collecting property taxes pursuant to the District's bond resolution. The carrying amounts for cash and temporary investment balances, which approximate fair value, at June 30, 2003, are as follows:

<u>Funds</u>	<u>Money Market Accounts</u>
General	1,121,905
Debt Service	840,309
Capital Projects	120,701
	<u>\$ 2,082,915</u>

The cash deposits held at financial institutions can be categorized according to three levels of risk. These three levels of risk are:

Category 1 Deposits that are insured or collateralized with securities held by the entity or by its agent in the entity's name.

Category 2 Deposits that are collateralized with securities held by the pledging financial institution's trust department or agent in the entity's name.

Category 3 Deposits that are not collateralized.

Based on these three levels of risk, at June 30, 2003, all of the District's cash deposits are classified as Category 1. However, during a brief period during the fiscal year, some of the cash deposits were classed as Category 3.

HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

NOTES TO FINANCIAL STATEMENTS

June 30, 2003

NOTE 4 - 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 1st, 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 \$0.097 was allocated to general operations and \$0.0465 was allocated to debt service. The total tax levy was \$2,991,370 based on an adjusted taxable property valuation of \$2,084,578,640 for the 2002 tax year. The total tax levy was allocated to general operations and debt service in the amounts of \$2,022,041 and \$969,329, respectively.

Taxes receivable at June 30, 2003, consist of the following:

<u>Tax Year</u>	<u>General</u>	<u>Debt Service</u>	<u>Totals</u>
2002	\$ 18,448	\$ 12,470	\$ 30,918
2001	9,681	4,524	14,205
2000	9,073	4,504	13,577
1999	5,192	2,418	7,610
1998	3,786	1,933	5,719
1997	3,726	2,315	6,041
1996	3,840	3,610	7,450
1995	5,798	4,868	10,666
1994	5,681	4,038	9,719
1993	1,815	3,490	5,305
	<u>\$ 67,040</u>	<u>\$ 44,170</u>	<u>\$ 111,210</u>

HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

NOTES TO FINANCIAL STATEMENTS

June 30, 2003

NOTE 5 - GENERAL FIXED ASSETS

A summary of changes in general fixed assets for the year ended June 30, 2003, follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Ending Balance</u>
Physical Facilities			
Streets and amenities	\$ 10,992,405	\$ 237,567	\$ 11,229,972
Equipment	298,978	1,700	300,678
Engineering and design	1,496,144	39,381	1,535,525
	<u>12,787,527</u>	<u>278,648</u>	<u>13,066,175</u>
District Organizational Costs			
Legal fees	319,357		319,357
Other costs	183,809		183,809
	<u>503,166</u>		<u>503,166</u>
Total General Fixed Assets	<u>\$ 13,290,693</u>	<u>\$ 278,648</u>	<u>\$ 13,569,341</u>

NOTE 6 - CHANGES IN GENERAL LONG-TERM DEBT, DEBT SERVICE REQUIREMENTS, AND BOND RESOLUTION REQUIREMENTS

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.

Summary of changes in general long-term debt for the year ended June 30, 2003, follows:

Outstanding balance, beginning of year	\$ 11,135,000
Retirements	<u>(345,000)</u>
Outstanding Balance, end of year	<u><u>10,790,000</u></u>

Information pertaining to bonds payable at June 30, 2003, follows:

	<u>Series 1993</u>	<u>Series 1999</u>
Original issue amount	\$ 11,000,000	\$ 2,000,000
Amount outstanding	\$ 8,880,000	\$ 1,910,000
Interest rates	5.25% to 7.25%	5.00% to 7.00%
Maturity dates	September 1, 1995 2019	September 1, 2001 2023
Interest payment dates	March 1/September 1	March 1/September 1
Callable date *	September 1, 2003	September 1, 2009

* Or any interest payment date thereafter at par value plus accrued interest from the most recent interest payment date to the date fixed for redemption.

HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

NOTES TO FINANCIAL STATEMENTS

June 30, 2003

NOTE 6 - CHANGES IN GENERAL LONG-TERM DEBT, DEBT SERVICE REQUIREMENTS, AND BOND RESOLUTION REQUIREMENTS (continued)

As of June 30, 2003, the debt service requirements on bonds outstanding are as follows:

<u>Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Totals</u>
2004	\$ 375,000	\$ 590,926	\$ 965,926
2005	400,000	562,958	962,958
2006	415,000	536,785	951,785
2007	435,000	512,580	947,580
2008	460,000	486,810	946,810
2009-2013	2,735,000	2,002,467	4,737,467
2014-2018	3,620,000	1,139,260	4,759,260
2019-2023	2,195,000	226,064	2,421,064
2024	155,000	4,553	159,553
	<u>\$ 10,790,000</u>	<u>\$ 6,062,403</u>	<u>\$ 16,852,403</u>

At June 30, 2003, the District had \$137,000,000 of authorized but unissued bonds, as follows:

Unlimited Tax Bonds	
Stimulation, expansion, and development of transportation	\$ 62,995,000
Conservation and preservation of natural resources	24,005,000
Tourism	<u>25,000,000</u>
	112,000,000
Bonds payable from assessments	<u>25,000,000</u>
	<u>\$ 137,000,000</u>

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

NOTE 7 - 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.

HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

NOTES TO FINANCIAL STATEMENTS

June 30, 2003

NOTE 7 - SIGNIFICANT LEGAL PROVISIONS OF LEGISLATIVE ACT CREATING THE DISTRICT
(continued)

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.

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.

HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

NOTES TO FINANCIAL STATEMENTS

June 30, 2003

NOTE 8 - 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:

Total Assets	\$	20,295
Total Liabilities		<hr/>
Total Fund Equity	\$	20,295
		<hr/> <hr/>
Total Revenues	\$	75,691
Total Expenses		<hr/> (62,585)
Excess Revenues (Expenses)	\$	13,106
		<hr/> <hr/>

NOTE 9 - LEASE OBLIGATIONS

The District is obligated under operating leases for office space, warehouse space, and equipment. Rental expenditures under these leases totaled \$119,244. The annual rental commitment for lease obligations is as follows:

<u>Year Ending June 30th</u>	<u>Amount</u>
2004	\$ 103,393
2005	66,684
2006	39,624
2007	14,704
	<hr/> \$ 224,405
	<hr/> <hr/>

NOTE 10 - 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, 2003, the District contributed \$60,182 to the plan.

HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

NOTES TO FINANCIAL STATEMENTS

June 30, 2003

NOTE 11 - 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 12 - 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, 2003, the District received \$454,920 from the TIRZ for reimbursement of a portion of planning expenditures incurred.

NOTE 13 - 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. Total value of the agreement is \$288,800, whereas HGAC will provide \$231,040 and the District will match twenty percent, or \$57,760 of the funding. This contract expired on September 30, 2003, and is expected to be renewed. The District has also entered into a five year contract with Metro for shuttle services for this program.

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**Independent Auditors' Report
on Internal Control**

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

In planning and performing our audit of the general purpose financial statements of Harris County Improvement District No. 1 for the year ended June 30, 2003, we considered its internal control, in order to determine our auditing procedures for the purpose of expressing our opinion on the general purpose financial statements and not to provide assurance on the internal control. However, we noted certain matters involving the internal control and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect the organization's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

Reportable Condition

We noted an instance when cash was not entirely covered by pledged collateral and/or Federal Depository Insurance Coverage during the year.

Recommendation

We recommend that cash balances are closely monitored to ensure that it is entirely covered throughout the year.

Reportable Condition

We noted that the general ledger and trial balance for the General Operating Fund did not balance at year-end. Also interfund and intergovernmental transactions – receivables, payables and transfers are not being reconciled.

Recommendation

We recommend that steps be taken to ensure that accounting data is accurate and that general ledgers are always in balance. Interfund balances should be reconciled and reimbursements made as needed.

A material weakness is a condition in which the design or operation of the specific internal control components does not reduce to a relatively low level, the risk that errors or irregularities in amounts that would be material in relation to the general purpose financial statements being audited may occur and not be detected within a timely period by responsible parties in the normal course of performing their assigned functions. However, we noted no matters involving the internal control and its operation that we consider to be material weaknesses as defined above.

This report is intended solely for the use of the Board of Directors, management, and the Texas Commission of Environmental Quality and is not intended and should not be used by anyone other than these specified parties.

We would like to thank the District's Board and administrative staff for their cooperation during the course of our audit. Please feel free to contact us at your convenience to discuss this report or any other concerns that you may have.

Houston, Texas

October 10, 2003