

**NORTH HARRIS COUNTY REGIONAL  
WATER AUTHORITY**

**FINANCIAL STATEMENTS**

**December 31, 2006**



**Null-Lairson**

CERTIFIED PUBLIC ACCOUNTANTS

PROFESSIONAL CORPORATION

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**NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY  
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## **Independent Auditors' Report**

Board of Directors  
North Harris County Regional Water Authority

We have audited the accompanying statements of net assets of the business type activities of North Harris County Regional Water Authority, as of December 31, 2006 and 2005, and the related statements of revenues, expenses and changes in net assets and cash flows for the years then ended, as listed in the table of contents. These financial statements are the responsibility of North Harris County Regional Water Authority'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. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the basic financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the basic financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall basic 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 financial position of the business type activities of North Harris County Regional Water Authority, as of December 31, 2006 and 2005, and the changes in financial position thereof for the years ended, in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis information listed in the table of contents is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. 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.

Our audits were conducted for the purpose of forming an opinion on the North Harris County Regional Water Authority's basic financial statements. The information beginning on page 38 appears as supplementary information. We have applied certain limited procedures which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However we did not audit the information and express no opinion on it.

*Null-Lairson, A.C.*

Houston, Texas  
March 12, 2007

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**Management's Discussion and Analysis**

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# **NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY**

## ***Management's Discussion and Analysis***

***December 31, 2006***

### **Using this Annual Report**

Within this section of the financial report of the North Harris County Regional Water Authority (the "Authority"), the Authority's Management provides narrative discussion and analysis of the financial activities of the Authority, for the fiscal year ended December 31, 2006. This analysis should be read in conjunction with the basic financial statements that follow this section.

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

This discussion and analysis is intended to serve as an introduction to the Authority's basic financial statements, which are comprised of the following: 1) statement of net assets, 2) statement of revenues, expenses and changes in net assets, 3) statement of cash flows and 4) notes to the financial statements. This report also contains supplementary information in addition to the basic financial statements themselves.

The statement of net assets presents information on all of the Authority'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 of changes in the financial position of the Authority.

The statement of revenues, expenses and changes in net assets presents information showing how the Authority'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 the 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 (e.g., earned but unused vacation leave).

### **Notes to the Financial Statements**

The notes provide additional information that is essential to a full understanding of the data provided in the basic financial statements.

**NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY**  
**Management's Discussion and Analysis**  
**December 31, 2006**

**Financial Analysis of the Authority**

In the government-wide statements, the difference between assets and liabilities is called net assets. The Authority's net assets at December 31, 2006, were \$8,329,810. Net assets are categorized based on their availability to provide financial resources for the Authority. Net assets that are "Invested in capital assets, net of related debt" represent the Authority's investments in capital assets, less any debt used to acquire those assets that is still outstanding. Resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities. "Restricted" net assets represent amounts that are restricted for future debt service requirements. "Unrestricted" net assets represent amounts available to meet the Authority's future obligations.

The Authority's overall financial position at December 31, 2006 as compared to the two prior years is summarized as follows, based on information contained in the statement of net assets:

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Current and other assets	\$ 118,779,859	\$ 128,902,722	\$ 94,321,583
Capital assets	164,970,204	154,923,008	73,179,200
<b>Total assets</b>	<u>283,750,063</u>	<u>283,825,730</u>	<u>167,500,783</u>
Current liabilities	762,305	491,314	359,217
Long term liabilities	274,657,948	278,305,864	164,225,929
<b>Total liabilities</b>	<u>275,420,253</u>	<u>278,797,178</u>	<u>164,585,146</u>
Net Assets			
Invested in capital assets, net of related debt	(33,476,343)	(34,256,626)	(24,687,570)
Restricted for debt service	7,825,401	14,418,661	8,740,450
Unrestricted	33,980,752	24,866,517	18,862,757
<b>Total net assets</b>	<u><u>\$ 8,329,810</u></u>	<u><u>\$ 5,028,552</u></u>	<u><u>\$ 2,915,637</u></u>

**NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY**

*Management's Discussion and Analysis*

*December 31, 2006*

**Financial Analysis of the Authority (continued)**

The Authority's net operating income for the year ended December 31, 2006 was \$10,571,367 with net non-operating expenses of \$7,270,109 resulted in an increase in net assets of \$3,301,258. Non-operating revenues and non-operating expenses represented interest income from the Authority's investments and interest expense from the Authority's debt. The increase in net assets was primarily the result of the increase in the pumpage fee rate, which was effective October 1, 2006. The rate increase is consistent with the Authority's financial planning and budgeting, and is used to satisfy bond covenants and debt service requirements.

A summarized comparison of the Authority's operations for the year ended December 31, 2006 with the previous two years is as follows, based on information in the statement of activities:

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Operating revenues	\$ 17,713,495	\$ 13,623,099	7,918,999
Operating expenses	<u>7,142,128</u>	<u>4,551,144</u>	<u>4,616,393</u>
Net operating income (loss)	10,571,367	9,071,955	3,302,606
Net non-operating revenue (expense)	<u>(7,270,109)</u>	<u>(6,959,040)</u>	<u>(6,430,194)</u>
Change in net assets	3,301,258	2,112,915	(3,127,588)
Net assets, beginning of year	<u>5,028,552</u>	<u>2,915,637</u>	<u>6,043,225</u>
Net assets, end of year	<u>\$ 8,329,810</u>	<u>\$ 5,028,552</u>	<u>\$ 2,915,637</u>

**NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY**  
**Management's Discussion and Analysis**  
**December 31, 2006**

**Capital Assets**

As of December 31, 2006, the Authority had invested \$151,226,669 (net of accumulated depreciation) in capital assets. These capital assets primarily consist of land, construction in progress, infrastructure and the Authority's interest in treated water facilities and water transmission facilities.

The Authority's capital assets at December 31, 2006, as compared to the two previous years is summarized as follows:

	<u>2006</u>	<u>2005</u>	<u>2004</u>
<b>Capital assets not being depreciated:</b>			
Land and ROW acquisition	\$ 9,810,939	\$ 8,104,474	\$ 4,259,132
Construction in progress	<u>3,932,596</u>	<u>58,028,461</u>	<u>17,747,716</u>
Total capital assets not being depreciated	13,743,535	66,132,935	22,006,848
<b>Capital assets being depreciated or amortized:</b>			
Interest in treated water facilities	52,454,277	52,454,277	51,492,844
Interest in transmission facilities	29,187,152	29,187,152	
Infrastructure	75,682,444	10,451,304	1,625,802
Furniture, computers & equipment	<u>141,361</u>	<u>134,693</u>	<u>121,496</u>
	157,465,234	92,227,426	53,240,142
Less accumulated depreciation and amortization	<u>(6,238,565)</u>	<u>(3,437,353)</u>	<u>(2,067,790)</u>
Total capital assets being depreciated or amortized	<u>151,226,669</u>	<u>88,790,073</u>	<u>51,172,352</u>
Total capital assets	<u>\$ 164,970,204</u>	<u>\$ 154,923,008</u>	<u>\$ 73,179,200</u>

During the current year, \$70,137,665 additional capital assets were added to the Authority. The additional capital assets consisted primarily of land, infrastructure, construction in progress and the costs related to the acquisition and improvements to a water well.

## **NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY**

### *Management's Discussion and Analysis*

*December 31, 2006*

#### **Capital Assets (continued)**

Construction has been completed on several projects related to the Groundwater Reduction Plan. Completed projects in the current period include those listed below. The approximate cost for these completed projects is \$70 million, which includes some engineering related to these projects and has been recorded, along with related depreciation, in the accompanying statement of net assets.

- Bammel North Houston distribution line (Project 1A)
- Water transmission line from Veterans Memorial Drive to NWHC MUD 23 water plant (Project 1A-2)
- Champion Forest distribution line (Project 1B)
- Northwest Harris County MUD No. 24 water plant improvements (Project 1C-2)
- Louetta regional water wells 1 & 2 (Project 5A)
- 16" Water line from Louetta to Charterwood (Project 5B)
- Louetta distribution line - Phases I, II and III (Projects 6, 6B, 7C1 and 7C2)
- Old Louetta Distribution line (Project 6A)
- Ella distribution line (Project 7A)
- 16" Water line along Ella (Project 7A-1)
- Ella/Kuykendahl distribution line (Project 7B)
- Costs associated with the acquisition and improvements to the Hewlett Packard water well (Project 19)
- Greens Road Water line (Project 18)

As noted above, capital assets include construction in progress on the following projects:

- Supervisory Control and Data Acquisition (SCADA) System (Project 101A)

The projects that are not complete as of fiscal year end, along with related engineering fees, have been recorded as construction in progress in the statement of net assets. Engineering fees related to various other projects that are in the preliminary phases have also been recorded as construction in progress in the statement of net assets. No depreciation has been provided for construction in progress.

**NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY**  
**Management's Discussion and Analysis**  
**December 31, 2006**

**Long-Term Obligations**

The Authority's total long term obligations at December 31, 2006, as compared to the previous two years is as follows:

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Capital contributions			
2003	\$ 32,573,177	\$ 32,573,177	\$ 32,573,177
2005	<u>14,675,978</u>	<u>14,675,978</u>	
	47,249,155	47,249,155	<u>32,573,177</u>
Revenue bonds			
Series 2003	124,685,000	124,685,000	124,685,000
Series 2005	93,875,000	93,875,000	
Unamortized bond premium	8,358,911	8,654,906	3,754,882
Unamortized bond discount	<u>(1,723,307)</u>	<u>(1,786,054)</u>	<u>(1,320,793)</u>
	225,195,604	225,428,852	127,119,089
Accrued compensated absences	<u>134,861</u>	<u>92,190</u>	<u>59,182</u>
	<u><u>\$ 272,579,620</u></u>	<u><u>\$ 272,770,197</u></u>	<u><u>\$ 159,751,448</u></u>

During 2006, the Authority has continued to comply with all its bond covenants and maintained its investment grade rating with Moody's and Standard and Poor's.

During the year, the Authority transferred the net amount of \$8,250,000 from the Revenue Fund to the Coverage Fund, in order to minimize the increase in pumpage fees necessary to satisfy the additional bond and rate covenants.

**NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY**  
**Management's Discussion and Analysis**  
**December 31, 2006**

**Next Year's Budget**

The Authority's 2007 budget as compared to actual results for 2006 is as follows:

	<u>2006 Actual</u>	<u>2007 Budget</u>
Operating revenues	\$ 17,713,495	\$ 20,951,500
Operating expenses	<u>(7,142,128)</u>	<u>(4,128,908)</u>
Net operating income	10,571,367	16,822,592
Interest revenues	5,901,563	2,000,000
Interest expense	<u>(13,171,672)</u>	<u>(13,407,682)</u>
Net non-operating expense	(7,270,109)	(11,407,682)
Change in net assets	3,301,258	5,414,910
Beginning net assets	<u>5,028,552</u>	<u>8,329,810</u>
Ending net assets	<u>\$ 8,329,810</u>	<u>\$ 13,744,720</u>

**Economic Factors**

The Harris-Galveston Subsidence District (HGSD) groundwater reduction requirements mandate that construction will begin on the infrastructure required to meet the 2010 conversion target of thirty percent reduction in groundwater use, along with requirements for higher conversion target thresholds which will take effect through the year 2030. The Authority's approved Groundwater Reduction Plan (GRP) defines how it will comply with this requirement.

Since October 2003, the Authority has adopted a Capital Improvement Plan (the "CIP") on an annual basis. The primary focus of the first CIP was to move forward in the definition, design and construction of the facilities necessary to allow implementation of the Groundwater Transfer Program (the "GTP"). The 2004-2005 CIP generally defined a program necessary to implement the GTP and moved forward with the definition of the alignment and purchase of easements required for the remainder of the 2010 Water Distribution and Transmission System. The 2005-2006 CIP is, in effect, an update and continuation of the 2004-2005 CIP. In addition, the 2005-2006 CIP identifies and defines additional issues which the Authority will address in the next two years. The most significant new items added to the 2005-2006 CIP were:

- the Authority's participation in the City of Houston Greens Road water line, which will serve as a portion of the Authority's 2010 Transmission System,
- identification and purchase of sites for the Authority's proposed 2020 regional pump stations and water plants,
- identification and securing necessary easements for a portion of the 2020 Transmission System identified in the GRP.

## **NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY**

### *Management's Discussion and Analysis*

*December 31, 2006*

#### **Economic Factors (continued)**

The 2006-2007 CIP continues the planning and development process begun when the Authority's Board adopted the first CIP in 2003. However, unlike the first two and current CIPs, the 2006-2007 CIP's focus is not the GTP. Rather, the 2006-2007 CIP defines and initiates a broad-based program to provide the remaining components of the system which will be needed to provide surface water to districts in 2010 and provides for the procurement of sites/easements for several of the key infrastructure components which will be needed to continue implementation of the GRP in 2020. Some of the significant activities provided for in the 2006-2007 CIP are as follows:

- Define the alignment, secure necessary easements and begin design of all the remaining 2010 distribution lines.
- Finalize the alignment, secure necessary easements and begin design on the 2010 Transmission Line from Greens Road water line to the T.C. Jester Regional Pump Station.
- Identify and purchase the site and begin design of the T.C. Jester Regional Pump Station.
- Begin design of the Louetta Regional Water Plant.
- Evaluate the need and as need is defined, locate and construct regional water wells.
- Define Supervisory Control and Data Acquisition (SCADA) System required to enable efficient operation of the 2010 system and initiate design.
- Finalize the alignment of a portion of the 2020 transmission line and secure necessary easements.
- Identify and purchase the site for each of the three 2020 regional water plants and two 2020 regional pump stations.
- Infrastructure purchase and/or participation agreements.
- Reuse program participation.
- Professional services to perform the wide variety of activities required to implement the CIP.

The GTP was implemented in January 2006. The 2007-2008 CIP continues and refines that program and quantifies the funding needed to allow construction of the required infrastructure to proceed as necessary thereby allowing the timely conversion to surface water in 2010.

#### **Request for Information**

This financial report is designed to provide a general overview of the Authority's finances. Questions concerning any information provided in this report or requests for additional information should be addressed to the Financial Assistant, North Harris County Regional Water Authority, 3648 FM 1960 West, Suite 110, Houston, Texas 77068.

**Basic Financial Statements**

**NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY**  
**Statement of Net Assets**  
**December 31, 2006 and 2005**

	<u>2006</u>	<u>2005</u>
<b>Assets</b>		
<b>Current assets</b>		
Cash	\$ 34,339	\$ 49,102
Investments	34,171,840	24,481,840
Accounts receivable other	180,425	919,079
Total current assets	<u>34,386,604</u>	<u>25,450,021</u>
<b>Noncurrent assets</b>		
Restricted cash and investments	80,619,353	99,544,176
Unamortized bond issuance costs	3,773,902	3,908,525
Capital assets not being depreciated	13,743,535	66,132,935
Capital assets net of accumulated depreciation	<u>151,226,669</u>	<u>88,790,073</u>
Total noncurrent assets	<u>249,363,459</u>	<u>258,375,709</u>
<b>Total assets</b>	<u>283,750,063</u>	<u>283,825,730</u>
<b>Liabilities</b>		
<b>Current liabilities</b>		
Accounts payable	246,966	
Other payables	24,025	
Interest payable on bonds	491,314	491,314
Total current liabilities	<u>762,305</u>	<u>491,314</u>
<b>Noncurrent liabilities</b>		
Accounts payable from restricted assets	2,032,159	3,502,233
Retainage payable from restricted assets	46,169	2,033,434
Accrued compensated absences	134,861	92,190
Capital contributions due in more than one year	47,249,155	47,249,155
Bonds payable due in more than one year (net of unamortized bond premium and discount)	<u>225,195,604</u>	<u>225,428,852</u>
Total noncurrent liabilities	<u>274,657,948</u>	<u>278,305,864</u>
<b>Total liabilities</b>	<u>275,420,253</u>	<u>278,797,178</u>
<b>Net assets</b>		
Invested in capital assets, net of related debt	(33,476,343)	(34,256,626)
Restricted for debt service	7,825,401	14,418,661
Unrestricted	<u>33,980,752</u>	<u>24,866,517</u>
<b>Total net assets</b>	<u>\$ 8,329,810</u>	<u>\$ 5,028,552</u>

See Notes to Financial Statements.

**NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY**  
*Statement of Revenues, Expenses and Changes in Net Assets*  
For the Years Ended December 31, 2006 and 2005

	<u>2006</u>	<u>2005</u>
<b>Operating revenues</b>		
Charges for services		
Pumpage fees	\$ 16,784,075	\$ 13,600,099
Water sales	928,314	
Other	1,106	23,000
<b>Total operating revenues</b>	<u>17,713,495</u>	<u>13,623,099</u>
<b>Operating expenses</b>		
Personnel	1,106,957	919,809
Professional fees	1,556,567	1,518,470
Purchased water	725,625	
Contracted services	213,135	8,933
Occupancy and office	339,591	321,541
Other	262,918	301,386
Depreciation and amortization	2,937,335	1,481,005
<b>Total operating expenses</b>	<u>7,142,128</u>	<u>4,551,144</u>
<b>Net operating income</b>	10,571,367	9,071,955
<b>Non-operating revenues (expenses)</b>		
Interest and fiscal charges expense	(13,171,672)	(10,917,279)
Interest income	5,901,563	3,958,239
<b>Total non-operating expense</b>	<u>(7,270,109)</u>	<u>(6,959,040)</u>
<b>Change in net assets</b>	3,301,258	2,112,915
<b>Total net assets - beginning</b>	<u>5,028,552</u>	<u>2,915,637</u>
<b>Total net assets - ending</b>	<u>\$ 8,329,810</u>	<u>\$ 5,028,552</u>

See Notes to Financial Statements.

**NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY**  
**Statements of Cash Flows**  
**For the Years Ended December 31, 2006 and 2005**

	<u>2006</u>	<u>2005</u>
<b>Cash flows from operating activities</b>		
Receipts from customers	\$ 18,452,149	\$ 13,623,099
Payments for personnel costs	(1,064,286)	(886,801)
Payments to contractors and vendors	<u>(2,826,845)</u>	<u>(2,231,960)</u>
Net cash provided by operating activities	<u>14,561,018</u>	<u>10,504,338</u>
<b>Cash flows from capital and related financing activities</b>		
Interest paid	(13,406,420)	(11,302,255)
Acquisition and construction of capital assets	(16,305,747)	(82,052,183)
Proceeds from issuance of debt		93,875,000
Bond issuance costs		(1,507,031)
Bond discount and premium		4,606,100
Accrued interest received on sale of bonds		526,606
Capital contributions		<u>13,656,545</u>
Net cash provided (used) by capital and related financing activities	<u>(29,712,167)</u>	<u>17,802,782</u>
<b>Cash flows from investing activities</b>		
Interest received	<u>5,901,563</u>	<u>3,958,239</u>
Net cash provided by investing activities	<u>5,901,563</u>	<u>3,958,239</u>
Net increase (decrease) in cash and cash equivalents	(9,249,586)	32,265,359
<b>Balances -beginning of the year</b>	<u>124,075,118</u>	<u>91,809,759</u>
<b>Balances - end of the year</b>	<u>\$ 114,825,532</u>	<u>\$ 124,075,118</u>
<b>Reconciliation of operating income to net cash provided by operating activities:</b>		
Operating income	\$ 10,571,367	\$ 9,071,955
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization expense	2,937,335	1,481,005
Change in assets and liabilities:		
Decrease in accounts receivable	738,654	
Increase (decrease) in accounts payable	270,991	(81,630)
Increase in compensated absences	<u>42,671</u>	<u>33,008</u>
Total adjustments	<u>3,989,651</u>	<u>1,432,383</u>
Net cash provided by operating activities	<u>\$ 14,561,018</u>	<u>\$ 10,504,338</u>
<b>Cash and cash equivalents per balance sheet:</b>		
Cash	\$ 34,339	\$ 49,102
Investments	34,171,840	24,481,840
Restricted cash and investments	<u>80,619,353</u>	<u>99,544,176</u>
	<u>\$ 114,825,532</u>	<u>\$ 124,075,118</u>

See Notes to Financial Statements.

# **NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY**

## *Notes to Financial Statements*

*December 31, 2006*

### **Note 1- Summary of Significant Accounting Policies**

The North Harris County Regional Water Authority (the “Authority”) was created in 1999 under Article 16, Section 59 of the Texas Constitution by House Bill 2965, as passed by the 75th Texas Legislature and as amended (the “Act”). The Authority began operations in October 1999. The Act empowers the Authority to provide for the conservation, preservation, protection, recharge and prevention of waste of groundwater and for the reduction of groundwater withdrawals.

The Authority may charge a fee, based on the amount of water pumped from the well, to the owner of wells located in the Authority’s boundaries, unless exempted. The fees established by the Board of Directors must be sufficient to: (1) achieve water conservation, prevent waste of water, serve as a disincentive to pumping groundwater and make available alternative water supplies; and (2) enable the Authority to meet operation and maintenance expenses and pay the principal and interest on any debt issued by the Authority.

The accompanying financial statements of the Authority have been prepared in conformity with accounting principles generally accepted in the United States of America. The following is a summary of the most significant policies:

#### **Reporting Entity**

The Authority is a political subdivision of the State of Texas governed by an elected five member board. As required by generally accepted accounting principles, these financial statements have been prepared based on considerations regarding the potential for inclusion of other entities, organizations or functions as part of the Authority’s financial reporting entity. No other entities, organizations or functions have been included in the Authority’s financial reporting entity. Additionally, as the Authority 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 Authority’s financial reporting entity are based on criteria prescribed by generally accepted accounting principles. These same criteria are evaluated in considering whether the Authority 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 Authority’s financial reporting entity status is that of a primary government are: that it has a separate governing body; it is legally separate; and it is fiscally independent of other state and local governments. Additional prescribed criteria under generally accepted accounting principles 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.

# **NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY**

## *Notes to Financial Statements*

*December 31, 2006*

### **Note 1- Summary of Significant Accounting Policies (continued)**

#### **Basic Financial Statements**

The basic financial statements include the statement of net assets, the statement of revenues, expenses and changes in net assets and the statement of cash flows. These statements focus on the sustainability of the Authority as an entity and the change in aggregate financial position resulting from these activities for the fiscal year.

#### **Measurement Focus and Basis of Accounting**

The Authority follows proprietary fund accounting and reporting requirements, which utilize the economic resources measurement focus and the accrual basis of accounting. The Authority follows generally accepted accounting principles prescribed by the Governmental Accounting Standards Board (GASB) and all Financial Accounting Standard Board's (FASB) standards issued prior to November 30, 1989. The Authority has elected not to apply FASB pronouncements issued after that date.

Proprietary funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues are charges to customers for pumpage fees. Operating expenses include the cost of services, administrative expenses and depreciation and amortization on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Net assets are classified into the following three components:

- 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, capital contribution credits or other borrowings.
- Restricted – this component of net assets consists of constraints placed on net assets used through external constraints imposed by creditors, grantors, contributors or laws or regulations of other governments or through contractual provisions or enabling legislation.
- Unrestricted – this component of net assets consists of net assets that do not meet the definition of the previous two categories.

#### **Cash and Investments**

The Authority's cash and investments consist of cash on hand, demand deposits and balances in TexPool, TexPool Prime and TexSTAR accounts, which are public funds investment pools. Amounts in these pools are stated at cost, which approximates market value. For the purposes of the statement of cash flows, the Authority considers investments in investment pools to be cash equivalents.

**NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY**

*Notes to Financial Statements*

*December 31, 2006*

**Note 1- Summary of Significant Accounting Policies (continued)**

**Receivables**

All receivables are reported at their gross value and, where appropriate, are reduced by an allowance for amounts considered uncollectible. At December 31, 2006 an allowance of \$34,364 was provided for possible uncollectible accounts.

**Restricted Assets**

Proceeds of bonds or other resources set aside for specific purposes are classified as restricted assets on the balance sheet because their use is limited by applicable bond covenants or contractual agreements.

**Capital Assets**

The Authority defines capital assets as assets with an individual cost of \$5,000 or more and an estimated useful life in excess of one year. Capital assets, which include land, right of way acquisition costs, infrastructure and interest in infrastructure assets constructed by the City of Houston, are reported at historical cost. Donated assets are recorded at their estimated fair value at the date of donation.

The costs of normal maintenance and repairs that do not add to the value of assets or materially extend asset lives are not capitalized. Capital assets are depreciated using the straight-line method over the following estimated useful lives:

<u>Asset</u>	<u>Years</u>
Computer and software	3
Furniture and equipment	5-7
Infrastructure	20-45

**Long Term Obligations**

Long term debt and other long term obligations are reported as liabilities on the Authority's statement of net assets. Bonds payable are reported net of any applicable discount or premium. Bond issuance costs are deferred and amortized over the life of the bonds to which they relate using the straight line method.

**NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY**

*Notes to Financial Statements*

*December 31, 2006*

**Note 1- Summary of Significant Accounting Policies (continued)**

**Compensated Employee Absences**

Compensated employee absences, which include vacation, compensatory time and sick leave, are accumulated during employment and are accrued when earned. The rate at which an employee earns benefits will vary depending upon their employment status, years employed and position with the Authority. Full-time employees are eligible for vacation time after six months employment and earn between 10 and 25 days vacation per year. At December 31, up to 40 hours of vacation leave is automatically converted to compensatory time. Employees who work at least 32 hours per week earn sick leave at the rate of 3-5 hours per pay period, not to exceed 480 hours. Upon termination, employees are paid for accumulated vacation and compensatory time. The General Manager is also entitled to receive compensation for accrued sick leave.

**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 reported amounts of assets and liabilities and disclosures 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 amounts could differ from those estimates.

**NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY**

*Notes to Financial Statements*

*December 31, 2006*

**Note 2 – Cash and Investments**

Cash consists of cash on hand and amounts in checking accounts. Investments consist of investments with TexPool, TexPool Prime and TexSTAR. The carrying amounts for cash and investment balances at December 31, 2006 and 2005 consisted of the following:

	<u>2006</u>	<u>2005</u>
<b>Cash</b>		
On hand	\$ 759	\$ 759
Checking accounts	<u>33,580</u>	<u>48,343</u>
	34,339	49,102
<b>Investments</b>		
TexPool	2,954,090	2,829,647
TexSTAR	<u>31,217,750</u>	<u>21,652,193</u>
	34,171,840	24,481,840
<b>Restricted Cash and Investments</b>		
Checking accounts	273,330	318,706
TexPool	24,128,522	36,026,854
TexPool Prime	48,416,559	48,133,362
TexSTAR	<u>7,800,942</u>	<u>15,049,721</u>
	<u>80,619,353</u>	<u>99,528,643</u>
<b>Total Cash and Investments</b>	<u>\$ 114,825,532</u>	<u>\$124,059,585</u>

Cash and investments were restricted for the following purposes at December 31, 2006 and 2005:

	<u>2006</u>	<u>2005</u>
Bond reserves	\$ 8,316,715	\$ 14,418,661
Capital improvements	<u>72,302,638</u>	<u>85,125,515</u>
	<u>\$ 80,619,353</u>	<u>\$ 99,544,176</u>

**Investment Policies** – The Authority is permitted under state statutes to invest in the following: (1) obligations of the United States or its agencies and instrumentalities; (2) direct obligations of the state of Texas or its agencies and instrumentalities; (3) certain collateralized mortgage obligations; (4) various obligations of any state or its political subdivisions; (5) bonds issued, assumed or guaranteed by the State of Israel; (6) certain certificates of deposit or share certificates; (7) certain fully collateralized repurchase agreements; (8) a securities lending program that complies with state statutes; (9) certain bankers' acceptances; (10) commercial paper; (11) various no-load money market mutual funds; (12) various no-load mutual funds; (13) certain guaranteed investment contracts and (14) an investment pool that invests exclusively in the obligations authorized in this section.

The Authority has adopted a written investment policy regarding the investment of its funds, which generally permits the Authority to invest in the same investments permitted under state statutes. The investments of the Authority are in compliance with its investment policies.

**NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY**

*Notes to Financial Statements*

*December 31, 2006*

**Note 2 – Cash and Investments (continued)**

**Custodial Credit Risk – Deposits** – State statutes and the Authority depository’s agreement require that all amounts deposited in financial institutions be covered by federal depository insurance and, if necessary, pledged collateral. The types of collateral to be pledged to secure the Authority’s funds are defined by state statutes. As of December 31, 2006, all of the Authority’s deposits are insured or fully collateralized.

**Investment Credit and Interest Rate Risk** - Investment credit risk is the risk that the investor may not recover the value of an investment from the issuer, while interest rate risk is the risk that the value of an investment will be adversely affected by changes in interest rates. The Authority’s investment policies do not address investment credit and interest rate risk beyond the rating and maturity restrictions established by state statutes. At December 31, 2006, TexPool is rated AAAM and has a sixty day weighted average maturity, this investment type comprises 100% of the Authority’s total investments.

**Investment Pools** - The State Comptroller of Public Accounts exercises oversight responsibility of TexPool, the Texas Local Government Investment Pool. 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. TexPool is rated AAAM by Standard & Poors. TexPool operates in a manner consistent with the SEC’s Rule 2a7 of the Investment Company Act of 1940. TexSTAR is operated in manner similar to TexPool but is managed by JPMorgan Fleming Asset Management (USA), Inc. and First Southwest Asset Management, Inc. TexPool and TexSTAR use amortized cost rather than market value to report net assets to compute share prices. Accordingly, the fair value of the position in TexPool and TexSTAR is the same as the value of TexPool and TexSTAR shares.

**NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY**

*Notes to Financial Statements*

*December 31, 2006*

**Note 3 – Capital Assets**

A summary of changes in capital assets during the year ended December 31, 2006, follows:

	Beginning Balance	Additions	Retirements	Ending Balance
<b>Capital assets not being depreciated:</b>				
Land and ROW acquisition	\$ 8,104,474	\$ 1,706,465	\$	\$ 9,810,939
Construction in progress	58,028,461	3,193,392	(57,289,257)	3,932,596
Total capital assets not being depreciated	66,132,935	4,899,857	(57,289,257)	13,743,535
<b>Capital assets being depreciated or amortized:</b>				
Interest in treated water facilities	52,454,277			52,454,277
Interest in transmission facilities	29,187,152			29,187,152
Infrastructure	10,451,304	65,231,140		75,682,444
Furniture, computers & equipment	134,693	6,668		141,361
Less accumulated depreciation and amortization	(3,437,353)	(2,801,212)		(6,238,565)
Total capital assets being depreciated or amortized	88,790,073	62,436,596		151,226,669
Total capital assets	<u>\$ 154,923,008</u>	<u>\$ 67,336,453</u>	<u>\$ (57,289,257)</u>	<u>\$ 164,970,204</u>

**NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY**

*Notes to Financial Statements*

*December 31, 2006*

**Note 3 – Capital Assets (continued)**

The Authority had the following contractual commitments for construction projects at December 31, 2006:

<u>Contract</u>	<u>Contractual Commitment</u>	<u>Construction in Progress</u>	<u>Remaining Commitment</u>
Supervisory Control and Data Acquisition (SCADA)	<u>\$ 1,011,000</u>	<u>\$ 923,378</u>	<u>\$ 87,622</u>

**Note 4 - Leases**

In 2000, the Authority entered into a lease for office space. The term of the lease was for five years. The lease was amended effective November 1, 2005 and will terminate on January 31, 2011. The Authority may terminate the lease anytime after thirty-six months, by giving twelve months written notice and by paying a lease termination penalty of \$19,500. The Authority has also entered into various leases for office equipment. The Authority paid \$100,868 under these leases during the current period. The annual commitments for leases are as follows:

<u>Year Ending</u>	<u>Amount</u>
2007	\$ 99,814
2008	103,439
2009	100,972
2010	<u>89,054</u>
Total	<u>\$ 393,279</u>

**Note 5 – Long -Term Obligations**

The Authority's long term obligations consist of revenue bonds, capital contributions (see Note 6) and compensated absences.

**Senior Lien Revenue Bonds**

The Authority issues Senior Lien Revenue Bonds (Senior Bonds) primarily to finance the design, acquisition and construction of regional water production, transmission, pumping, storage and distribution systems. The principal and interest on the Authority's bonds will be repaid from net revenues and from capital contributions as described in Note 6.

**NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY**

*Notes to Financial Statements*

*December 31, 2006*

**Note 5 – Long -Term Obligations (continued)**

Long-term debt, as reported on the financial statements for years ending 2006 and 2005 is comprised of the following:

	2006	2005
Bonds Payable	\$ 218,560,000	\$ 218,560,000
Unamortized premiums	8,358,911	8,654,906
Unamortized discounts	(1,723,307)	(1,786,054)
Total	<u>\$ 225,195,604</u>	<u>\$ 225,428,852</u>
Due within one year	<u>\$ 0</u>	<u>\$ 0</u>

Bonds payable at December 31, 2006 are comprised of the following issues:

<u>Series</u>	<u>Amounts Outstanding</u>	<u>Original Issue Amount</u>	<u>Interest Rates</u>	<u>Serially, Beginning /Ending</u>	<u>Interest Payment Dates</u>	<u>Callable Date</u>
2003	\$ 124,685,000	\$ 124,685,000	5.00% - 5.25%	December 15, 2010/2033	June 15 / December 15	December 15, 2013
2005	93,875,000	93,875,000	3.50% - 5.25%	December 15, 2010/2033	June 15 / December 15	December 15, 2014
	<u>\$ 218,560,000</u>					

**NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY**

*Notes to Financial Statements*

*December 31, 2006*

**Note 5 – Long -Term Obligations (continued)**

The Senior Bonds are secured by a lien on and pledge of the net revenues of the Authority. As additional security, the bond resolutions required the establishment of an Interest and Sinking Fund, a Reserve Fund and a Coverage Fund. A description of each fund follows:

- Interest and Sinking Fund - Used to accumulate the funds required to make the scheduled payments of debt service on the Senior Bonds. Money in the Interest and Sinking Fund shall be used solely for the purpose of paying principal, interest and any bank charges and other costs associated with payments of debt service on the Senior Bonds. Investments restricted for this fund as of December 31, 2006 were \$3,575,186.
- The Reserve Fund –Used (to the extent that amounts on deposit in the Interest and Sinking Fund and the Coverage Fund are insufficient) to pay the principal and interest on the Senior Bonds as it becomes payable. An insurance surety bond is on hand to secure performance and satisfy bond covenants.
- The Coverage Fund – Used to accumulate funds equal to 25% of the maximum annual debt service requirements for outstanding debt in any fiscal year. As of December 31, 2006, investments restricted by bond covenants for this fund were \$3,916,529, with an additional \$31,217,750 designated by the Authority (see Note 7).
- Operation and Maintenance Reserve Fund – Funds from gross revenues of the Authority will be deposited on or before the last business day of the month into this account. Investments restricted for this fund were \$825,000 as of December 31, 2006.

Funds from the Revenue Fund will first be used to pay operating and maintenance expenses, then the excess will be deposited into the Interest and Sinking Fund, then into the Reserve Fund, then into the Coverage Fund and then into the Operation and Maintenance Reserve Fund. On or before the last day of each fiscal year, all remaining net revenues will be deposited into an Improvement Fund, which may be used by the Authority for any lawful purpose.

The Authority was in compliance with the bond covenants as of December 31, 2006.

**NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY**

*Notes to Financial Statements*

*December 31, 2006*

**Note 5 – Long -Term Obligations (continued)**

As of December 31, 2006, the debt service requirements on the Senior Bonds outstanding are as follows:

<u>Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Totals</u>
2007	\$	\$ 11,054,556	\$ 11,054,556
2008		11,054,556	11,054,556
2009		11,054,556	11,054,556
2010	4,605,000	11,054,556	15,659,556
2011	4,810,000	10,851,981	15,661,981
2012	5,025,000	10,635,356	15,660,356
2013	5,275,000	10,384,106	15,659,106
2014	5,545,000	10,115,156	15,660,156
2015	5,835,000	9,824,044	15,659,044
2016	6,145,000	9,517,706	15,662,706
2017	6,470,000	9,195,094	15,665,094
2018	6,810,000	8,855,418	15,665,418
2019	7,165,000	8,497,893	15,662,893
2020	7,540,000	8,121,731	15,661,731
2021	7,935,000	7,725,881	15,660,881
2022	8,355,000	7,309,293	15,664,293
2023	8,775,000	6,883,293	15,658,293
2024	9,225,000	6,435,868	15,660,868
2025	9,685,000	5,974,618	15,659,618
2026	10,175,000	5,490,368	15,665,368
2027	10,680,000	4,981,618	15,661,618
2028	11,215,000	4,447,618	15,662,618
2029	11,775,000	3,886,868	15,661,868
2030	12,360,000	3,298,118	15,658,118
2031	12,980,000	2,680,118	15,660,118
2032	13,635,000	2,031,118	15,666,118
2033	14,315,000	1,349,368	15,664,368
2034	5,960,000	626,531	6,586,531
2035	6,265,000	321,081	6,586,081
<b>Totals</b>	<u>\$ 218,560,000</u>	<u>\$ 203,658,468</u>	<u>\$ 422,218,468</u>

Principal and interest payments on the Senior Bonds will be provided through the payment of pumpage fees by utility districts and non-exempt well owners.

**NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY**

*Notes to Financial Statements*

*December 31, 2006*

**Note 5 – Long -Term Obligations (continued)**

**Compensated Absences**

The Authority’s liability for compensated absences changed as follows:

	<u>2006</u>	<u>2005</u>
Balance at beginning of year	\$ 92,190	\$ 59,182
Increase in liability	134,861	92,190
Decrease in liability	<u>(92,190)</u>	<u>(59,182)</u>
Balance at end of year	<u>\$ 134,861</u>	<u>\$ 92,190</u>

**Note 6 – Capital Contributions**

In 2003, the Authority entered into contracts with twenty-four Municipal Utility Districts (MUDs) to provide funds to pay capital expenditures of the Authority’s system. Each MUD has paid a Capital Contribution based on a percentage of its pro-rata share of the total groundwater production for all water utilities during the calendar year 2002. Capital contributions of \$32,573,177 were made to the Authority in the 2003 fiscal year. The participating MUDs began receiving contribution credits against their individual pumpage fees distributed over the life of the Series 2003 Senior Bonds beginning with the 2003 third quarter pumpage fees. Any amounts remaining plus accrued interest at the end of the capital contribution expiration date will be credited against any amounts owed to the Authority by the MUDs or paid to the MUDs by the Authority.

In 2005, the Authority entered into agreements with nineteen MUDs. Capital contributions of \$14,675,978 were made to the Authority in the 2005 fiscal year. The participating MUDs began receiving contribution credits against their individual pumpage fees distributed over the life of the Series 2005 Senior Bonds beginning with the 2005 third quarter pumpage fees. As with the 2003 contribution credits, any amounts remaining plus accrued interest at the end of the capital contribution date will be credited against any amounts owed to the Authority by the MUDs or paid to the MUDs by the Authority.

**NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY**

*Notes to Financial Statements*

*December 31, 2006*

**Note 6 – Capital Contributions (continued)**

Future contribution credits including interest at the effective interest rate of the 2003 Senior Bonds as of December 31, 2006 are as follows:

<u>Year</u>	<u>Contribution Credits</u>	<u>Year</u>	<u>Contribution Credits</u>
2007	\$ 1,647,402	2021	\$ 2,373,821
2008	1,647,402	2022	2,373,821
2009	1,647,402	2023	2,373,821
2010	2,373,821	2024	2,373,821
2011	2,373,821	2025	2,373,821
2012	2,373,821	2026	2,373,821
2013	2,373,821	2027	2,373,821
2014	2,373,821	2028	2,373,821
2015	2,373,821	2029	2,373,821
2016	2,373,821	2030	2,373,821
2017	2,373,821	2031	2,373,821
2018	2,373,821	2032	2,373,821
2019	2,373,821	2033	2,373,821
2020	2,373,821	Totals	<u>\$ 61,913,910</u>

Future contribution credits including interest at the effective interest rate of the 2005 Senior Bonds as of December 31, 2006 are as follows:

<u>Year</u>	<u>Contribution Credits</u>	<u>Year</u>	<u>Contribution Credits</u>
2007	\$ 705,724	2022	\$ 1,000,879
2008	705,724	2023	1,000,879
2009	705,724	2024	1,000,879
2010	1,000,879	2025	1,000,879
2011	1,000,879	2026	1,000,879
2012	1,000,879	2027	1,000,879
2013	1,000,879	2028	1,000,879
2014	1,000,879	2029	1,000,879
2015	1,000,879	2030	1,000,879
2016	1,000,879	2031	1,000,879
2017	1,000,879	2032	1,000,879
2018	1,000,879	2033	1,000,879
2019	1,000,879	2034	1,000,879
2020	1,000,879	2035	1,000,879
2021	1,000,879	Totals	<u>\$ 28,140,026</u>

## **NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY**

### *Notes to Financial Statements*

*December 31, 2006*

#### **Note 7 – Unrestricted Net Assets**

Included in the Authority's unrestricted net assets of \$33,980,752, is \$31,217,750 which the Authority has designated as additional bond reserves. These funds have been deposited in the coverage fund discussed in Note 5.

#### **Note 8 – Risk Management**

The Authority is exposed to various risks related to torts: theft of, damage to and destruction of assets; errors and omissions; and natural disasters. The Authority's risk management program encompasses various means of protecting the Authority against loss by obtaining property, casualty and liability coverage through commercial insurance carriers. There have been no significant reductions in insurance coverage. Settlement amounts have not exceeded insurance coverage for the current year or the three prior years.

#### **Note 9 – Deferred Compensation Plans**

The Authority offers its employees a deferred compensation plan created in accordance with Internal Revenue Code, Section 457. The plan is available and permits employees to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death or unforeseeable emergency. The plan is administered by the International City Management Association - Retirement Corporation (ICMA-RC).

#### **Note 10 – Pension Plan**

The Authority has established the North Harris County Regional Water Authority Qualified Pension Plan 401(a) (the "Plan"). The Plan covers all employees. Under the terms of the Plan, active participants become 100% vested on the fifth anniversary of employment. Participants are eligible for payment of benefits upon reaching age 65, becoming disabled or separating from service for any other reason. Benefits are distributed in accordance with the instructions of the participants. The Board of Directors appointed ICMA-RC to serve as Plan administrator and trustee. The Plan provides for a minimum Authority contribution of 7% of total current covered payroll. At December 31, 2006, all of the Authority's employees were members of the Plan. Non-vested contributions are immaterial to total contributions at December 31, 2006. Vested contributions are solely the possession of participating employees. Total current payroll was \$925,040 for the year ended December 31, 2006, of which the entire amount was covered under the Plan. Employer contributions to the Plan for the year ended December 31, 2006 were \$62,088.

In 2003, the Authority established an additional 401(a) plan for management employees only. It is identical to the above Plan with the following exceptions: 1) management employees are fully vested on the second anniversary of employment and 2) the Plan provides for a minimum Authority contribution of 22% for the current year annual covered payroll of the General Manager. The total payroll and employer contributions for this plan are included in the totals above.

## **NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY**

### *Notes to Financial Statements*

*December 31, 2006*

#### **Note 11 – Water Supply Contracts**

In December 2002, the Authority entered into a forty year contract with the City of Houston (Houston) for the purchase of capacity in certain untreated water facilities and treated water facilities, including transmission facilities, of Houston. Under the terms of the contract, Houston will provide surface water to the Authority at a point of delivery to be located near Highway 59 and Beltway 8.

The contract stipulates that the Authority will purchase capacity, in phases, in Houston's surface water system. Houston will be responsible for the design, construction, ownership, maintenance and operation of both treated and untreated water facilities prior to the point of delivery. The Authority will be responsible for the design, construction, ownership, maintenance and operation of all facilities located beyond the point of delivery.

During 2003, the Authority made its first payment of \$51,492,844 to Houston for the purchase of capacity in Houston's treated water facilities and transmission facilities constructed prior to the effective date of the contract.

The Authority will pay Houston, on a monthly basis, its pro-rata share of operating and maintenance costs of the treated and untreated water facilities and transmission lines based on an annual operating budget. Such monthly payments will include an amount adequate to establish an operating reserve. The contract also provides the Authority with the option to purchase additional capacity in the future.

In March 2003, the Authority entered into an Interim Treated Water Supply Contract with Houston. Subject to the terms of this contract, the Authority entered into an agreement with Emerald Forest Utility District (the "District") for water supply. In the 2003 fiscal year, the Authority reimbursed the District \$36,694 for the cost of constructing a water line to Houston's line. During the current year, the Authority paid Houston \$57,569 on behalf of the District for purchased water.

#### **Note 12 – Agreement for Joint Financing of Facilities**

On November 3, 2003, the Authority entered into an Agreement for Joint Financing, Design, Construction, Operation and Maintenance of Surface Water Transmission Facilities (Joint Financing Agreement) with Harris County Municipal Utility District No. 33 (No. 33) for the Central Harris County Water Users Consortium, now Central Harris County Regional Water Authority (CHCRWA), a consortium of conservation and reclamation districts established and operating pursuant to the Central Harris County Water Users Consortium Agreement, dated December 13, 2002. Under the terms of the Joint Financing Agreement, the Authority will construct a sixty-inch water transmission line that is currently planned to commence at the point of delivery, as defined in the Authority's Water Supply Contract with Houston (see Note 11) to enable the Authority and the CHCRWA to receive surface water from the Northeast Water Purification Plant. The joint use facilities shall be completed no later than December 31, 2009.

**NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY**

*Notes to Financial Statements*

*December 31, 2006*

**Note 12 – Agreement for Joint Financing of Facilities (continued)**

The CHCRWA requires a means to receive surface water from Houston for delivery to the Member Districts and desires to participate in the financing, design, construction, operation and maintenance of the proposed water transmission line. The Authority will hold title to the joint use facilities and the CHCRWA will pay a pro-rata share of the costs of right-of-way acquisition, design and construction costs for the joint use facilities. The CHCRWA will escrow funds with the Authority for each phase of the construction and design. When each phase is complete, a summary of costs will be done and any excess or deficiency will be settled at that time. The CHCRWA will also be responsible for its pro-rata share of operation and maintenance costs of the facilities and, in addition, will be required to establish an operation and maintenance cost reserve with the Authority, based on an annual operation and maintenance budget. The current total estimated cost of the transmission line is \$63,681,140, with the Authority's share being 90.38% and the CHCRWA share being 9.62% of such costs.

**Note 13 – Interlocal Agreements**

**Greens Road Water Line.** The Authority entered into an interlocal agreement with the City of Houston (Houston), effective March 11, 2005, for the term of forty years, for the design and construction of the Greens Road water line that will provide the water transmission capacity necessary to serve the needs of Houston and the Authority. Houston has provided estimates to the Authority for real estate costs, engineering costs and contingencies for the project as well as the manner of calculation of such costs and the parties pro rata share of such costs. In the 2005 fiscal year, the Authority paid Houston its pro rata share of estimated construction costs and contingencies in the amount of \$29,187,152. Houston will perform a final accounting on the project and provide this amount to the Authority. Any adjustments to the final costs will be either billed to the Authority or refunded to the Authority by Houston. The amount of the final project cost is undeterminable at this time. Houston shall hold legal title to the Greens Road Project, however, Houston and the Authority shall each have an undivided equitable interest in, and use and benefit of capacity in the Greens Road water line, in accordance with their pro rata shares of capacity. The estimated capacity of the water line is 76.8 MGD, of which the Authority requires capacity of 44 MGD at the point of delivery in order to have adequate supply of treated surface water for distribution to the Authority's customers to comply with the Harris-Galveston Coastal Subsidence District's 1999 Regulatory Plan, as amended. Houston shall maintain and operate the Greens Road water line. The Authority will be billed for operation and maintenance costs based on their pro rata share of capacity and based on the budget approved by Houston and the Authority.

**NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY**

*Notes to Financial Statements*

*December 31, 2006*

**Note 13 – Interlocal Agreements (continued)**

**Louetta Regional Water Plant.** On February 16, 2005, the Authority entered into an interlocal agreement with Charterwood Municipal Utility District (Charterwood) and V&W Partners, Ltd. (V&W), for the term of forty years. The purpose of this agreement is to enable the Authority to construct a regional water plant in the area of Charterwood to be known as the Louetta Regional Water Plant (the “Louetta Plant”), enable Charterwood to obtain a supply of water for domestic use to supplement the water supply of Charterwood and to satisfy the needs of V&W for water service from Charterwood for 98 acres for commercial and residential development, which has been annexed into Charterwood. Under the terms of the agreement, the Authority will purchase a 30 foot wide water line easement from V&W to be used for the placement of two large diameter water lines from the plant site. Upon execution of the agreement, the Authority drilled a test hole for a well on the plant site to determine the feasibility and viability of the proposed wells. The drilling of the test hole was completed in the 2005 fiscal year at the cost of \$260,210, which includes construction costs and engineering. Under the terms of the agreement, the Authority shall proceed with the construction of the production wells. Upon determination that there is at least one feasible production well, the Authority will proceed with the design and construction of a water line from the plant site to Charterwood’s Water Plant No. 2. The water line will be used by the Authority to convey water from the Authority’s production well to Charterwood’s Water Plant No. 2 in order for Charterwood to provide a supply of water to its customers and ultimately to provide surface water to Charterwood subsequent to the Authority’s conversion to surface water. Upon completion of the two water lines, the Authority will own, operate and maintain the lines. Charterwood shall proceed with the construction of additional facilities, including pumps, chlorination equipment, storage tanks and other related equipment that are necessary to treat and deliver the water delivered to Charterwood’s Water Plant No. 2 by the Authority. The Authority shall pay Charterwood its pro rata share of the capital costs of the additional facilities. In the 2005 fiscal year, the Authority paid \$961,433 for its estimated share of the cost of the additional facilities.

Upon completion of the facilities, a final accounting will be made of construction costs and either the Authority will pay Charterwood for the additional costs in excess of the estimate or Charterwood will refund the excess amount to the Authority. In addition, the Authority shall pay Charterwood its pro rata share of the direct costs to repair and maintain the additional facilities. The Authority agrees to deliver water to Charterwood’s Water Plant No. 2, at the point of delivery, in an amount mutually agreed upon by Charterwood and the Authority. Charterwood agrees to purchase water from the Authority to provide a supply of water to its customers. All water delivered by the Authority to Charterwood will be billed to Charterwood and, in turn, water delivered to the Authority by Charterwood will be billed to the Authority. In addition, Charterwood will be able to receive a non-depreciated asset credit for Charterwood’s existing water supply facilities based in the date each facility was constructed, not to exceed \$0.80 per 1,000 gallons of water purchased from the Authority.

## **NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY**

### *Notes to Financial Statements*

*December 31, 2006*

#### **Note 14 – Buy / Sell Agreements**

In fiscal years 2005 and 2006 the Authority entered into Buy/Sell agreements for implementation of the Groundwater Transfer Program (GTP) with eighteen utility districts for the purpose of encouraging the maximum utilization of existing water production facilities to provide water to districts that are currently in need of water from districts with a surplus of water. The first priority of the GTP is to supply water to districts with water quality issues such as arsenic, secondly to districts needing additional water for growth and finally to districts needing additional water for peaking purposes. The primary purpose of the GTP is to limit construction of new water wells and related water production facilities that will have limited use after the conversion to surface water in 2010. During a delivery period, a seller shall sell, and the Authority may purchase a volume of water equal to an amount determined by the Authority to be required from a seller to meet demand and create a minimum flow within the Authority's system. The Authority shall sell, and a buyer shall purchase, a volume of water equal to at least the minimum water demand allocation, if any, and not to exceed the maximum water demand allocation by up to ten percent. A buyer shall pay the Authority for water it receives from the Authority for the purchase price of \$1.70 less applicable depreciation credit times the volume of water delivered by the Authority to the buyer. The depreciation credit shall be limited to a maximum of \$0.80 per 1,000 gallons of water purchased. The Authority shall pay the seller the sale price of \$0.91 plus an amount equal to the pumpage fee times the volume of water delivered to the Authority by a seller. The GTP program was implemented in January, 2006. During this time the Authority recorded \$851,160 in revenue and \$668,056 in expenditures for water exchanged for this program.

#### **Note 15 – Water Well Agreement**

On March 28, 2006, The Authority entered into a Water Well Agreement (the "Agreement") with V&W Partners, Ltd. (V&W), for itself and on behalf of the to be created Harris County Municipal Utility District No. 468 (MUD). Under the terms of the agreement, the Authority agreed to acquire a water well from V&W for a price of \$567,306. The Authority will also purchase easements from V&W which will be used for the placement of two water lines which will be purchased by the Authority. The Authority will deliver water, in the amount stated in the agreement, from the water well to the MUD water plant in order to serve customers of the MUD. In addition to the amounts specified in the agreement, the MUD shall be entitled to obtain up to 100,000 GPD to provide water supply service to the Hewlett Packard Data Center (HP Data Center). The MUD has interconnect agreements with Charterwood Municipal Utility District and Harris County Municipal Utility District No. 286 and will be required to provide water to these districts in emergency situations. The Authority intends to utilize the water well to supplement its water supply facilities located north of Louetta Road and may utilize water to serve customers of the Authority.

**NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY**

*Notes to Financial Statements*

*December 31, 2006*

**Note 15 – Water Well Agreement (continued)**

Any amount pumped by the Authority and delivered to the MUD shall be treated by the MUD and delivered to the Authority's point of measurement is subject to treatment charges as described in the agreement. The requirements for delivery and treatment of water shall apply until such time as the Authority delivers surface water to the MUD in accordance with the Authority's GRP. Upon delivery of surface water to the MUD, any water pumped from the water well will be sent to the Authority's water plant north of Louetta Road and the Authority will not be authorized to transmit water directly to the MUD water plant. The MUD agrees to treat water delivered from the Authority's water well to the MUD water plant and the Authority agrees to pay the MUD for the treatment of the water based upon the MUDs then current cost to treat water. The initial charge for the treatment of water will be \$0.84 per 1,000 gallons of water delivered to the Authority's point of measurement and shall be adjusted on an annual basis beginning October 1, 2007. The MUD will bill the Authority on a monthly basis for the treated water delivered through the Authority point of measurement. In turn, the Authority will bill the MUD on a monthly basis for the water delivered to the MUD in the amount of \$1.40 per 1,000 gallons of water, which will be increased from time to time as stipulated in the agreement. The MUD will not be required to pay a pumpage fee for such water. At such time the MUD takes surface water from the Authority, the MUD will only be required to pay the amount established by the Authority for the purchase of surface water. Until such time as the HP Data Center takes water from the MUD, the MUD will be required to pay a reservation fee of \$0.40 per 1,000 gallons for the 100,000 GPD reserved for the HP Data Center. If the HP Data Center obtains water from the MUD then the reserved amount and the corresponding reservation charge will be reduced according to the amount of water obtained. The term of this agreement is forty years with options to renew for successive five year periods, unless terminated by mutual agreement of the parties. As of December 31, 2006, the Authority has recorded a liability for \$567,306 for the purchase of the water well and \$608,075 for the cost of the improvements to the water well in accordance with the Agreement.

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## **Supplementary Information**

**NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY**

*Schedule of Expenses  
Last Five Fiscal Years*

	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>
<b>Personnel</b>					
Employee salaries	\$ 900,140	\$ 736,679	\$ 645,026	\$ 432,969	\$ 237,409
Employee retirement	88,884	75,649	69,662	30,589	17,481
Group insurance	51,900	50,802	46,841	42,968	25,791
Medicare/ Social security	59,840	51,028	44,162	29,694	18,518
Workers' compensation insurance	4,033	5,462		948	903
Unemployment compensation	2,160	189	1,449	378	540
	<u>1,106,957</u>	<u>919,809</u>	<u>807,140</u>	<u>537,546</u>	<u>300,642</u>
<b>Professional fees</b>					
Legal	132,978	221,475	202,567	675,006	337,455
Engineering	1,256,984	1,140,686	1,410,000	4,163,023	1,116,430
Financial services	11,205	8,809	16,278	54,221	28,924
Legislative consultant	130,000	130,000	108,000	300,000	99,000
Redistricting/mapping	4,400		1,000	8,900	9,727
Audit	21,000	17,500	9,500	8,725	6,000
	<u>1,556,567</u>	<u>1,518,470</u>	<u>1,747,345</u>	<u>5,209,875</u>	<u>1,597,536</u>
<b>Purchased Services</b>					
Bulk water purchases	57,569	50,784	22,793	9,154	
Water purchase - GTP	668,056				
	<u>725,625</u>	<u>50,784</u>	<u>22,793</u>	<u>9,154</u>	
<b>Contracted services</b>					
Operations and maintenance	206,747				
Temporary services	6,388	8,933	10,425	12,906	6,024
	<u>213,135</u>	<u>8,933</u>	<u>10,425</u>	<u>12,906</u>	<u>6,024</u>
<b>Occupancy and office</b>					
Office lease	87,628	85,547	91,135	87,801	76,704
Safe deposit box	60	60	60	60	90
Printing and office	63,721	110,138	92,742	51,883	46,891
Postage and delivery	25,712	31,793	47,364	27,885	46,832
Telephone	17,454	15,205	12,975	9,080	5,991
Utilities	64,883	3,107	945	840	
Equipment leases	13,241	7,476	11,019	9,665	10,690
Meeting sites	2,826	2,562	956	200	4,085
Internet service		3,468	3,458	3,007	2,703
Communication services	63,017	62,185	56,359	50,998	40,642
Web page	1,050			1,455	4,755
Remodeling					37,341
	<u>339,592</u>	<u>321,541</u>	<u>317,013</u>	<u>242,874</u>	<u>276,724</u>

**NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY**

*Schedule of Expenses*

*Last Five Fiscal Years*

	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>
<b>Other</b>					
Director fees	\$ 24,900	\$ 26,550	\$ 32,400	\$ 28,500	\$ 29,850
Election expense	4,900				60,248
Technology transfer projects	47,438	42,363	54,472	117,794	
Insurance	10,717	12,678	11,775	4,924	6,540
Travel and per diem	38,305	31,241	27,291	19,343	17,976
Legal notices			2,627	5,774	161
Membership/Subscription fees	5,219	5,423	5,922	5,028	3,951
Computer services	11,058	11,398	13,561	14,504	8,883
Computer software and equipment	27,155	9,701	30,306		345
Maintenance and repairs	5,379	5,445	15,513	15,772	21,482
Book and covers				8,036	8,547
Office furniture	1,331	10,610	17,547		
Public education		23,279	10,200		823
Water conservation	63,087	50,941	52,757		
Mileage reimbursement	5,962	4,220	5,044	3,747	8,618
Permit fees	7,742	7,559	200	1,400	
Seminars/training	8,895	5,435	6,351	4,500	7,623
Security	676	3,281	517	416	790
Miscellaneous	153	478	499	1,019	556
	<u>262,917</u>	<u>250,602</u>	<u>286,982</u>	<u>230,757</u>	<u>176,393</u>
<b>Expenses Before Depreciation and Amortization</b>	<u>4,204,793</u>	<u>3,070,139</u>	<u>3,191,698</u>	<u>6,243,112</u>	<u>2,357,319</u>
Depreciation and Amortization	<u>2,937,335</u>	<u>1,481,005</u>	<u>1,424,695</u>	<u>685,531</u>	<u>41,465</u>
<b>Total Expenses</b>	<u>\$ 7,142,128</u>	<u>\$ 4,551,144</u>	<u>\$ 4,616,393</u>	<u>\$ 6,928,643</u>	<u>\$ 2,398,784</u>

**NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY**  
*Schedule of Principal Water Users*  
*December 31, 2006*

Name	Pumpage (gallons)	Pumpage Fees Paid	Share (%)
Tomball, City of	726,264,000	\$ 468,301	2.7076%
Harris Co. FWSD 61	670,228,000	433,755	2.4987%
Harris Co. MUD 358	617,191,153	389,477	2.3010%
Harris Co. WCID 109	513,596,000	331,939	1.9148%
Harris Co. MUD 383	505,418,000	322,534	1.8843%
Bridgestone MUD	501,183,000	323,628	1.8685%
AquaSource, Inc.	499,157,189	317,059	1.8609%
Harris Co. MUD 365	495,492,000	315,261	1.8473%
Cypress Forest PUD	495,479,000	317,158	1.8472%
Faulkey Gully MUD	481,125,473	317,063	1.7937%
Subtotal	5,505,133,815	3,536,175	20.5240%
All other retail utilities	19,954,827,953	13,145,419	74.3952%
All private well owners	1,362,815,395	864,325	5.0808%
Total	26,822,777,163	\$ 17,545,919	100.0000%

**NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY**

*Miscellaneous Information*

*December 31, 2006*

**Rates and Charges**

<u>Effective Date</u>	<u>Pumpage Fee (Rate Per 1,000 Gallons of Water Pumped)</u>
January 1, 2000	\$ 0.12
April 1, 2000	0.25
October 1, 2003	0.34
April 1, 2005	0.59
October 1, 2006	0.84
October 1, 2007	0.99

**Billing and Collection Experience**

<u>Calendar Year Ending</u>	<u>Pumpage Reported to Subsidence District (gallons)</u>	<u>Pumpage Reported to Authority (gallons)</u>	<u>Percentage</u>
2002	23,385,003,226	23,304,243,101	99.65%
2003	23,922,957,131	23,919,899,118	99.99%
2004	23,055,346,850	23,002,955,882	99.77%
2005	28,356,373,609	28,351,195,157	99.98%
2006	26,834,935,391	26,822,777,163	99.95%