

Harris County Flood Control District
A Component Unit of Harris County, Texas

Basic Financial Statements



**For the Fiscal Year Ended
February 28, 2006 (Restated)**

County Judge Ed Emmett and
Members of Commissioners Court of
Harris County, Texas:

The accompanying Audit Reports for the year ended February 28, 2006, for Harris County Flood Control District, A Component Unit of Harris County, Texas have been revised to incorporate the effects of the restatement of the 2006 financial statements. A summary of the revisions is as follows:

- Independent Auditors' Report for the year ended February 28, 2006, was revised to refer to the footnote 11 in the financial statements regarding the restatement of the 2006 financial statements. This report was therefore dual dated.
- Footnote 11 has been revised to reflect the effects of the restatement of the financial statements as of and for the year ended February 28, 2006.
- Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based Upon the Audit Performed in Accordance with *Government Auditing Standards* is required by *Government Auditing Standards*. As the Independent Auditors' Report was dual dated (as noted in the first comment above), so too was the Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based Upon the Audit Performed in Accordance with *Government Auditing Standards*.
- Notes to the Schedule of Expenditures of Federal and State Awards was revised to add Note 3, discussing the identification of material weaknesses.
- The Schedule of Finding and Questioned Costs was revised to include material weaknesses identified during the fiscal year 2006 audit. In addition, a reference to such material weaknesses (06-02 and 06-03) was added in the Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based Upon the Audit Performed in Accordance with *Government Auditing Standards*.

Deloitte & Touche LLP

September 25, 2007

***Harris County Flood Control District
A Component Unit of Harris County, Texas***

*Basic Financial Statements and Single Audit
for the Fiscal Year Ended February 28, 2006 (Restated)
And Independent Auditors' Report*

**HARRIS COUNTY FLOOD CONTROL DISTRICT
A COMPONENT UNIT OF HARRIS COUNTY, TEXAS
BASIC FINANCIAL STATEMENTS
FISCAL YEAR ENDED FEBRUARY 28, 2006 (Restated)
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INDEPENDENT AUDITORS' REPORT (AS REVISED)

County Judge Ed Emmett
and Members of Commissioners Court
of Harris County, Texas:

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Harris County Flood Control District (the "District"), a component unit of Harris County, Texas (the "County") as of and for the year ended February 28, 2006, which collectively comprise the District's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on the respective financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America ("generally accepted auditing standards") and the standards applicable to financial statements contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the respective financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the respective financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund and the aggregate remaining fund information of the District as of February 28, 2006, and the respective changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 11 to the financial statements, the accompanying 2006 financial statements have been restated. As discussed in Note 3 to the Schedule of Expenditures of Federal Awards, the Schedule of Findings and Questioned Costs was revised for the inclusion of material weaknesses related to the financial statements.

The Management's Discussion and Analysis and Schedule of Revenue and Expenditures – Budget and Actual – Budgetary Basis – Operations and Maintenance (General) Fund are not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the District's management. 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 such information and we do not express an opinion on it.

Our audit was conducted for the purpose of forming an opinion on the District's basic financial statements. The Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis and is not a required part of the basic financial statements, but is supplementary information required by the U. S. Office of Management and Budget ("OMB") Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. This schedule is the responsibility of the District's management. This schedule has been subjected to the auditing procedures applied by us in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole. The supplemental schedules listed in the table of contents are presented for purposes of additional analysis and are not a required part of the basic financial statements. This supplementary information is also the responsibility of the District's management. The supplementary schedules have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

In accordance with *Government Auditing Standards*, we have also issued our report dated July 27, 2006 (September 25, 2007 as to the effects of the restatement discussed in Note 11 to the Financial Statements and Note 3 to the Schedule of Expenditures of Federal Awards), on our consideration of the District's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Deloitte & Touche LLP

July 27, 2006 (September 25, 2007 as to the effects of the restatement discussed in Note 11 to the Financial Statements and Note 3 to the Schedule of Expenditures of Federal Awards)

***Harris County Flood Control District
Management's Discussion and Analysis
(Unaudited)***

This section of the Harris County Flood Control District's (the "District") financial statements presents management's discussion and analysis ("MD&A") of the financial activities of the District during the fiscal year ended February 28, 2006. Please read it in conjunction with the District's basic financial statements following this section.

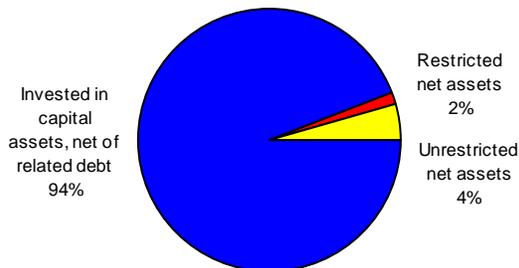
The District is a component unit of Harris County, Texas (the "County") and is included as a blended component unit in the County's financial statements. This analysis presents information about the District and the operations and activities of the District only and is not intended to provide information about the entire County.

FINANCIAL HIGHLIGHTS

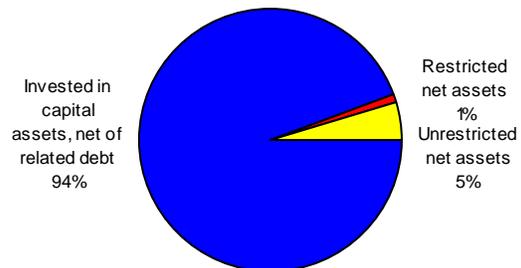
Government-wide

- The total government-wide assets of the District exceeded the liabilities (net assets) at February 28, 2006 by \$1,521,344,479. This is comparable to the previous year when assets exceeded liabilities by \$1,480,667,268 (as restated, Note 11). The restatement of prior year net assets is the result of an overstatement of bond premium which was net of amortization and the understatement of capital assets.
- Total net assets are comprised of the following:
 - (1) Capital assets, net of related debt, of \$1,431,525,678 include land, improvements, construction in progress and equipment, net of accumulated depreciation, and reduced for outstanding debt related to the purchase or construction of capital assets. Invested in capital assets, net of related debt remained unchanged at 94% of total net assets.
 - (2) Net assets of \$22,629,349 are restricted by constraints imposed from outside the District such as debt obligations. Restricted net assets increased from 1% to 2% of total net assets.
 - (3) Unrestricted net assets of \$67,189,452 represent the portion available to meet ongoing obligations to citizens and creditors. The decrease from 5% to 4% of total net assets is primarily due to an increase in restricted net assets.

NET ASSETS BY CATEGORY
February 28, 2006



NET ASSETS BY CATEGORY
February 28, 2005



***Harris County Flood Control District
Management's Discussion and Analysis
(Unaudited)***

Fund Level

- As of February 28, 2006, the District's governmental funds reported combined fund balances of \$210,177,844. This compares to the prior year combined fund balance of \$212,505,752 showing a decrease of \$2,327,908 during the current year. The combined unreserved fund balance of \$109,569,035 for fiscal year 2006 shows a decrease of \$12,832,713 over the prior year. These decreases were primarily attributable to an increase in reserves for encumbrances.
- At the end of the fiscal year, the total fund balance for the Operations and Maintenance (General) fund was \$77,295,109. The unreserved fund balance was \$52,150,492 or 66.9% of total general fund expenditures and 91.1% of total general fund revenues. The General fund had a reserved fund balance of \$25,144,617 which is set aside for encumbrances and debt service. An increase in revenues was the primary reason total fund balance increased by \$2,225,386 this year.
- The fund balance in the Debt Service fund of \$15,240,258 was fully reserved at the end of the fiscal year. This represents a decrease of \$3,693,908 from the prior year balance of \$18,934,166. Revenues, primarily from taxes, declined by \$2,606,701 and expenditures decreased by \$4,457,618 primarily due to decreased debt service requirements.
- The Capital Projects fund at fiscal year end had an unreserved fund balance of \$57,418,543 and a reserved fund balance of \$60,223,934 for a total Capital Projects fund balance of \$117,642,477 down from \$118,501,863 in the prior year.
- The District issues debt to finance an ongoing capital improvement program, and during fiscal year 2006, issued \$51,845,000 in commercial paper. Note 6 to the financial statements, provides additional details related to long-term debt. The debt service ad-valorem tax rate for the 2005 tax year for the District totaled \$0.00589 per \$100 valuation.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis are intended to serve as an introduction to the District's basic financial statements, which are comprised of three components: 1) Government-wide financial statements; 2) Fund financial statements; and 3) Notes to the basic financial statements. Required Supplementary Information is included in addition to the basic financial statements.

Government-wide Financial Statements are designed to provide readers with a broad overview of District finances, in a manner similar to a private-sector business.

The statement of net assets presents information on all District 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 whether the financial position of the District is improving or deteriorating. However, other non-financial factors should also be considered to assess the overall fiscal health of the District.

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

***Harris County Flood Control District
Management's Discussion and Analysis
(Unaudited)***

Typically, both of these government-wide financial statements would distinguish functions of the reporting entity principally supported by taxes and intergovernmental revenues (governmental activities) from other functions that are intended to recover all or in part a portion of their costs through user fees and charges (business-type activities). The District, however, has and reports only governmental activities.

Fund Financial Statements are groupings of related accounts that are used to maintain control over resources that have been segregated for specific activities or objectives. The District, like other state and local governments, uses fund accounting to ensure and demonstrate finance-related legal compliance. Funds can be divided into three categories: governmental funds, proprietary funds and fiduciary funds. However, the District has four governmental funds and one fiduciary fund.

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

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

The District maintains four individual governmental funds. As all of these funds are considered major funds, information is presented separately in the governmental funds balance sheet and in the governmental funds statement of revenues, expenditures and changes in fund balances for each of the funds – Operations and Maintenance (General), Special Revenue Grants, Debt Service, and Capital Projects.

Fiduciary funds are used to account for resources held for the benefit of parties outside the government. Fiduciary funds are not reflected in the government-wide financial statements because the resources of those funds are not available to support the District's own programs. The District uses one agency fund to report resources held by the District in a purely custodial capacity (assets and liabilities) and therefore do not involve the measurement of results of operations.

Notes to the Basic Financial Statements provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes can be found beginning on page 19 of this report.

Required Supplementary Information is presented concerning the District's Operations and Maintenance (General) Fund budgetary schedule. The District adopts an annual budget for this fund. A budgetary comparison schedule, which includes the original and final amended budgets and actual figures, has been provided to demonstrate compliance with these budgets. Required supplementary information can be found beginning on page 39 of this report.

***Harris County Flood Control District
Management's Discussion and Analysis
(Unaudited)***

GOVERNMENT-WIDE FINANCIAL ANALYSIS

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. In the case of the District, assets exceeded liabilities by \$1,521,344,479 for fiscal year ended 2006 and \$1,480,667,268 (as restated, Note 11) for fiscal year 2005. Net assets increased primarily due to an increase in capital assets. For further information regarding the increase in capital assets see Note 5 and Note 11 to the financial statements.

**Condensed Statement of Net Assets
(Amounts in thousands)**

	Governmental Activities (as restated, Note 11)	
	February 28, 2006	February 28, 2005
Current and other assets	\$ 237,638	\$ 232,210
Capital Assets	1,796,188	1,719,731
Total assets	<u>2,033,826</u>	<u>1,951,941</u>
Current and other liabilities	29,750	20,724
Long-term liabilities	482,732	450,550
Total liabilities	<u>512,482</u>	<u>471,274</u>
Net assets:		
Invested in capital assets, net of related debt	1,431,526	1,396,541
Restricted net assets	22,629	13,252
Unrestricted net assets	67,189	70,874
Total net assets	<u>\$ 1,521,344</u>	<u>\$ 1,480,667</u>

The largest portion of the District's current fiscal year net assets, \$1,431,525,678 or 94% of the total, reflects its investments in capital assets (e.g. land, improvements, buildings, equipment, infrastructure), less any related debt used to acquire those assets that is still outstanding. The main use of these capital assets is to provide services to citizens; consequently, these assets are not available for future spending. Although the District's investment in its capital assets is reported net of related debt, it should be noted that resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities. The increase of \$34,984,470 in the District's net assets invested in capital assets, net of related debt is comprised of an \$76,456,651 increase in capital assets with an offsetting increase of \$32,683,674 in debt related to capital assets and decrease of unspent debt proceeds of \$8,788,507.

2% of the District's current fiscal year net assets represents resources that are subject to external restrictions on how they may be used. Restricted net assets totaled \$22,629,349 with \$12,268,867 restricted for capital projects and \$10,360,482 restricted for debt service. Due to increased outside funding for joint projects in the current year, restricted net assets increased \$9,377,572.

The remaining balance of the District's current fiscal year net assets, 4% or \$67,189,452 represents unrestricted net assets, which may be used by the District for current and future needs.

At the end of the current fiscal year, the District reported positive balances in all three categories of net assets for its separate governmental activities.

The following table indicates changes in net assets for governmental activities:

**Harris County Flood Control District
Management's Discussion and Analysis
(Unaudited)**

**Condensed Statement of Activities
(Amounts In Thousands)**

	Governmental Activities (as restated, Note 11)	
	<u>February 28, 2006</u>	<u>February 28, 2005</u>
Revenues:		
Program revenues:		
Charges for services	\$ 1,008	\$ 2,545
Operating grants and contributions	22,734	5,802
Capital grants and contributions	47,310	47,062
General revenues:		
Property taxes	66,061	65,955
Earnings on investments	6,207	1,789
Miscellaneous	904	2,005
Gain on sale of capital assets	534	218
Total revenues and other items	<u>144,758</u>	<u>125,376</u>
Expenses:		
Flood control	84,205	84,468
Tax Administration	441	574
Interest on long-term debt	19,435	15,404
Total expenses and other items	<u>104,081</u>	<u>100,446</u>
Change in net assets	40,677	24,930
Net assets - beginning	1,480,667	1,455,737
Net assets - ending	<u>\$ 1,521,344</u>	<u>\$ 1,480,667</u>

Revenues

For fiscal year ended February 28, 2006, revenues from governmental activities totaled \$144,757,960.

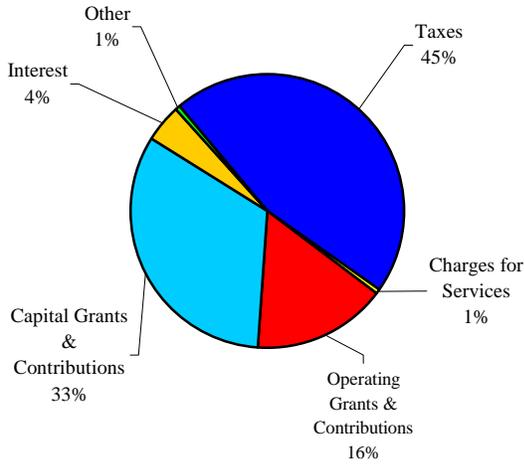
Property taxes of \$66,061,359 were the District's largest revenue source and comprised 45% of total revenues. The tax rate was \$.03322 per \$100 of assessed value for fiscal year 2006 and \$.03318 per \$100 of assessed value for fiscal year 2005. The assessed value increased in fiscal year 2006 to \$267,364,118,000 from \$231,497,956,000 in fiscal year 2005.

Program revenues are derived from the program itself and reduce the cost of the function to the District. Total program revenues were \$71,051,975 or 50% of total revenues. A major portion of program revenues are capital grants and contributions of \$47,309,773 (33%) and represent receipts primarily from Federal Emergency Management Agency (FEMA) and the Army Corps of Engineers. The second largest portion of program revenues consists of operating grants and contributions of \$22,734,308 (16%), associated with contributions by Harris County and state grant programs. Another portion of program revenues is charges for services of \$1,007,894 (1%), which are primarily from impact fees on development.

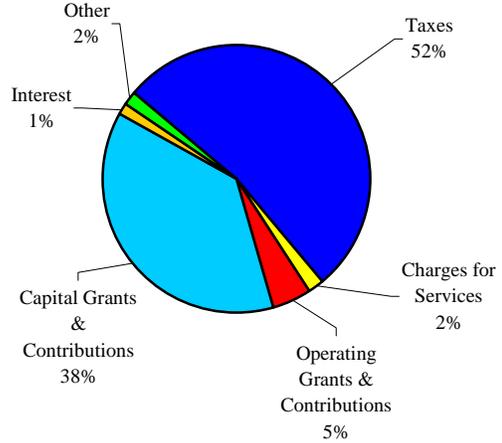
General revenues are revenues that can not be assigned to a specific function. They consist of property taxes (discussed above), unrestricted investment or interest earnings of \$6,207,050 (4% of total revenues), miscellaneous income of \$904,099 and gain on sale of capital assets of \$533,477 (both less than 1% of total revenues). Miscellaneous income is primarily comprised of collections for various fees.

**Harris County Flood Control District
Management's Discussion and Analysis
(Unaudited)**

REVENUES BY SOURCE
Year ended February 28, 2006



REVENUES BY SOURCE
Year ended February 28, 2005

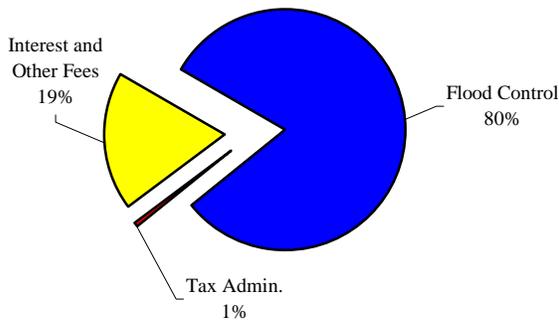


Expenses

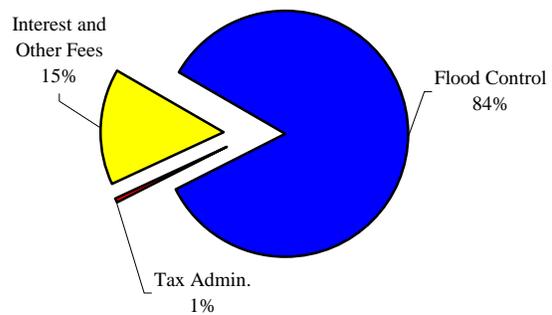
For fiscal year ended February 28, 2006, expenses for governmental activities totaled \$104,080,749, compared to \$100,446,236 for fiscal year 2005.

Flood control administration is the District's largest function with \$84,205,058 or 80% of total expenses. This was a decrease from the prior year of \$263,088. Interest on long term debt makes up the second largest category of expenses with \$19,434,892 or 19% of the total, up from \$15,404,007 last year. Tax administration, which represents the cost to collect taxes assessed on behalf of the District by the Harris County Tax Assessor is \$440,799 or approximately 1% of total expenses and has declined from \$574,083 last year.

EXPENSES BY FUNCTION
Year ended February 28, 2006



EXPENSES BY FUNCTION
Year ended February 28, 2005



***Harris County Flood Control District
Management's Discussion and Analysis
(Unaudited)***

FINANCIAL ANALYSIS OF MAJOR FUNDS

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

At February 28, 2006, the District's governmental funds reported combined fund balances of \$210,177,844, of which \$83,501,284 is reserved for encumbrances, \$17,102,478 is reserved for debt service and \$5,047 is reserved for prepaid expenses. The remainder, \$109,569,035, is available to meet the District's current and future needs. The District's combined fund balances decreased \$2,327,908. The reasons for this change are explained below by individual fund.

The Operating and Maintenance (General) fund is the operating fund of the District. Fund balance in the General Fund increased by \$2,225,386. This was primarily the result of an increase in tax revenue as a result of an increase in the operations and maintenance component of the tax rate from .02553 to .02733 per \$100 valuation. A decrease in capital outlay expenditures also contributed to the change.

The Special Revenue Grants fund has been created this year to account for the addition of grants that have been awarded in the District's name. In prior fiscal years grants were awarded to Harris County with the District operating them on behalf of the County. There is no fund balance in grant funds.

Fund balance in the Debt Service fund decreased by \$3,693,908, primarily as the result of a reduction in property tax revenues, caused by a decrease in the debt service component of the tax rate. At February 28, 2006, this fund reported revenues of \$13,229,528 compared to \$15,836,229 for fiscal year 2005. The majority of these revenues were from property taxes. See Note 3 to the financial statements for additional information on property taxes.

The fund balance in the Capital Projects fund decreased by \$859,386, which was due to expenditures exceeding revenues and the use of commercial paper proceeds. The Capital Projects fund relies primarily on the issuance of bonds and commercial paper to support current and future projects. The funding for projects was provided through commercial paper and joint funded projects with outside agencies. See Note 6 to the financial statements for further discussion of commercial paper.

OPERATING AND MAINTENANCE (GENERAL) FUND BUDGETARY HIGHLIGHTS

Differences between the original budget and the final amended budget resulted in a \$21,147,175 increase in available resources and a \$21,161,939 increase in appropriations.

During the year actual revenues exceeded budgetary estimates by \$7,830,724. This is attributable to unanticipated property tax revenues. Actual expenditures were less than budgetary estimates by \$70,725,543. This is primarily due to fewer expenditures than anticipated in the general operating flood control account. The net effect of the under-realization of revenues and appropriations resulted in a positive variance of \$78,556,267, thus eliminating the need to draw upon the existing fund balance.

***Harris County Flood Control District
Management's Discussion and Analysis
(Unaudited)***

CAPITAL ASSETS

The District's capital assets, net of accumulated depreciation for its governmental activities as of February 28, 2006, amounted to \$1,796,187,815. These capital assets include land, improvements, buildings, flood control infrastructure, equipment, and construction in progress, as shown in the table below. For further information regarding capital assets, see Note 5 to the financial statements.

	Balance February 28, 2006 (as restated, Note 11)	Balance February 28, 2005 (as restated, Note 11)
Governmental Activities:		
Land	\$ 1,369,292,587	\$ 1,342,755,732
Construction in Progress	158,053,574	132,523,608
Buildings	3,330,706	3,330,706
Equipment	7,635,387	7,117,902
Flood Control Projects	433,628,493	396,173,803
	<u>1,971,940,747</u>	<u>1,881,901,751</u>
Less Accumulated Depreciation	(175,752,932)	(162,170,587)
Totals	<u><u>\$ 1,796,187,815</u></u>	<u><u>\$ 1,719,731,164</u></u>

LONG-TERM DEBT

At February 28, 2006, the District had total long-term liabilities outstanding of \$482,732,323. Refer to Note 6 to the financial statements for further information on the District's long term debt.

	Outstanding at February 28, 2006	Outstanding at February 28, 2005
Governmental Activities:		
Bonds Payable (as restated, Note 11)	\$ 403,967,127	\$ 423,633,671
Commercial Paper Payable	78,425,000	26,580,000
Compensatory Time Payable	340,196	336,229
Totals (as restated, Note 11)	<u><u>\$ 482,732,323</u></u>	<u><u>\$ 450,549,900</u></u>

ECONOMIC FACTORS

The unemployment rate for Harris County for calendar year 2005 was 5.4%. This is a favorable decrease from the prior year rate of 5.9%. The state unemployment rate for calendar year 2005 was 4.8%. The number of people employed with Harris County increased by 437 during the year.

REQUEST FOR INFORMATION

This financial report is designed to provide a general overview of the District's finances for all those with an interest in the District's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the County Auditor's Office, 1001 Preston, Suite 800, Houston, Texas 77002, or visit the County's website at www.co.harris.tx.us.

BASIC FINANCIAL STATEMENTS

HARRIS COUNTY FLOOD CONTROL DISTRICT
A COMPONENT UNIT OF HARRIS COUNTY, TEXAS
STATEMENT OF NET ASSETS
February 28, 2006

	Governmental Activities (as restated, Note 11)
ASSETS	
Cash and investments:	
Cash and cash equivalents	\$ 16,214,814
Investments	192,454,417
Receivables:	
Taxes, net	2,566,585
Accounts	13,798,988
Accrued interest	1,200,008
Other	6,019,803
Due from primary government	881,869
Prepays and other assets	5,047
Restricted cash and investments	1,862,220
Deferred charges	2,634,980
Capital assets:	
Land and construction in progress	1,527,346,161
Other capital assets, net of depreciation	268,841,654
Total assets	2,033,826,546
LIABILITIES	
Liabilities:	
Vouchers payable	13,247,552
Accrued payroll and compensated absences	1,567,738
Retainages payable	2,099,240
Due to primary government	5,344,318
Accrued interest	7,490,896
Long-term liabilities:	
Due within one year:	
Bonds payable	17,070,000
Commercial paper payable	7,129,545
Compensated absences	265,353
Due in more than one year:	
Bonds payable	386,897,127
Commercial paper payable	71,295,455
Compensated absences	74,843
Total liabilities	512,482,067
NET ASSETS	
Invested in capital assets, net of related debt	1,431,525,678
Restricted for debt service	10,360,482
Restricted for capital projects	12,268,867
Unrestricted	67,189,452
Total net assets	\$ 1,521,344,479

See notes to the financial statements.

**HARRIS COUNTY FLOOD CONTROL DISTRICT
A COMPONENT UNIT OF HARRIS COUNTY, TEXAS
STATEMENT OF ACTIVITIES
For The Year Ended February 28, 2006**

<u>Functions/Programs</u>	<u>Expenses (as restated, Note 11)</u>	<u>Charges for Services</u>	<u>Program Revenues</u>		<u>Net (Expense) Revenue and Changes in Net Assets</u>
			<u>Operating Grants and Contributions (as restated, Note 11)</u>	<u>Capital Grants and Contributions (as restated, Note 11)</u>	<u>Governmental Activities (as restated, Note 11)</u>
Governmental activities:					
Flood control administration	\$ 84,205,058	\$ 1,007,894	\$ 22,734,308	\$ 47,309,773	\$ (13,153,083)
Tax administration	440,799	-	-	-	(440,799)
Interest on long-term debt	19,434,892	-	-	-	(19,434,892)
Total governmental activities	<u>104,080,749</u>	<u>1,007,894</u>	<u>22,734,308</u>	<u>47,309,773</u>	<u>(33,028,774)</u>
General revenues:					
Taxes:					
Property taxes levied for general purposes					54,161,116
Property taxes levied for debt service					11,900,243
Earnings on investments					6,207,050
Miscellaneous					904,099
Gain on sale of capital assets					533,477
Total general revenues and other items					<u>73,705,985</u>
Change in net assets (as restated, Note 11)					40,677,211
Net assets - beginning (as restated, Note 11)					<u>1,480,667,268</u>
Net assets - ending					<u>\$ 1,521,344,479</u>

See notes to the financial statements.

HARRIS COUNTY FLOOD CONTROL DISTRICT
A COMPONENT UNIT OF HARRIS COUNTY, TEXAS
BALANCE SHEET
GOVERNMENTAL FUNDS
February 28, 2006

	Operations and Maintenance (General)	Special Revenue Grants	Debt Service	Capital Projects	Total 2006
ASSETS					
Cash and investments:					
Cash and cash equivalents	\$ 9,311,890	\$ -	\$ 1,693,628	\$ 5,209,296	\$ 16,214,814
Investments	67,830,897	-	12,638,566	111,984,954	192,454,417
Receivables:					
Taxes, net	1,817,685	-	748,900	-	2,566,585
Accounts	323	2,554,516	-	11,244,149	13,798,988
Accrued interest	177,788	-	3,494	1,018,726	1,200,008
Other	2,625,435	2,743,059	651,309	-	6,019,803
Due from other funds	34,025	17,246	-	2,291	53,562
Due from primary government	624,907	-	253,261	3,701	881,869
Prepays and other assets	5,047	-	-	-	5,047
Restricted cash and cash equivalents	1,862,220	-	-	-	1,862,220
Total assets	<u>\$ 84,290,217</u>	<u>\$ 5,314,821</u>	<u>\$ 15,989,158</u>	<u>\$ 129,463,117</u>	<u>\$ 235,057,313</u>
LIABILITIES AND FUND BALANCE					
Liabilities:					
Vouchers payable	\$ 3,348,901	\$ 19,404	\$ -	\$ 9,879,247	\$ 13,247,552
Accrued payroll and compensated absences	1,567,738	-	-	-	1,567,738
Retainages payable	175,244	-	-	1,923,996	2,099,240
Due to other funds	-	36,316	-	17,246	53,562
Due to primary government	85,217	5,259,101	-	-	5,344,318
Deferred revenue	1,818,008	-	748,900	151	2,567,059
Total liabilities	<u>6,995,108</u>	<u>5,314,821</u>	<u>748,900</u>	<u>11,820,640</u>	<u>24,879,469</u>
Fund balances:					
Reserved for:					
Encumbrances	23,277,350	-	-	60,223,934	83,501,284
Debt service	1,862,220	-	15,240,258	-	17,102,478
Prepays	5,047	-	-	-	5,047
Unreserved	52,150,492	-	-	57,418,543	109,569,035
Total fund balances	<u>77,295,109</u>	<u>-</u>	<u>15,240,258</u>	<u>117,642,477</u>	<u>210,177,844</u>
Total liabilities and fund balances	<u>\$ 84,290,217</u>	<u>\$ 5,314,821</u>	<u>\$ 15,989,158</u>	<u>\$ 129,463,117</u>	<u>\$ 235,057,313</u>

See notes to the financial statements.

**HARRIS COUNTY FLOOD CONTROL DISTRICT
A COMPONENT UNIT OF HARRIS COUNTY, TEXAS
RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET
TO THE STATEMENT OF NET ASSETS
February 28, 2006**

Total fund balances for governmental funds \$ 210,177,844

Total net assets reported for governmental activities in the statement of net assets is different because:

Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds. Those assets consist of:

Land	\$ 1,369,292,587	
Construction in progress	158,053,574	
Flood control projects, net of \$170,090,687 accumulated depreciation	263,537,806	
Buildings, net of \$1,326,459 accumulated depreciation	2,004,247	
Equipment and vehicles, net of \$4,335,786 accumulated depreciation	<u>3,299,601</u>	
Total capital assets (See Note 5)		1,796,187,815

Long-term liabilities applicable to the Flood Control District's activities are not due and payable in the current period and accordingly are not reported as fund liabilities. Interest on long-term debt is not accrued in governmental funds, but rather is recognized as an expenditure when due. All liabilities - both current and long-term - are reported in the statement of net assets.

Balances as of February 28, 2006 were:

Accrued interest on bonds	(7,490,896)	
Bonds payable	(403,967,127)	
Deferred charges	2,634,980	
Commercial paper payable	(78,425,000)	
Compensated absences	<u>(340,196)</u>	
		(487,588,239)

Some of the District's revenues will be collected after year-end but are not available soon enough to pay for the current period's expenditures and therefore are deferred in the funds.

2,567,059

Total net assets of governmental activities

\$ 1,521,344,479

See notes to the financial statements.

HARRIS COUNTY FLOOD CONTROL DISTRICT
A COMPONENT UNIT OF HARRIS COUNTY, TEXAS
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
GOVERNMENTAL FUNDS
For The Year Ended February 28, 2006

	Operations and Maintenance (General) (as restated, Note 11)	Special Revenue Grants	Debt Service	Capital Projects (as restated, Note 11)	Total 2006 (as restated, Note 11)
REVENUES					
Taxes	\$ 54,925,527	\$ -	\$ 12,764,330	\$ -	\$ 67,689,857
Intergovernmental	-	9,756,640	-	15,410,954	25,167,594
Lease revenue	136,385	-	-	-	136,385
Earnings on investments	1,903,542	-	425,606	3,857,411	6,186,559
Miscellaneous	239,234	1,245	39,592	1,516,028	1,796,099
	<u>57,204,688</u>	<u>9,757,885</u>	<u>13,229,528</u>	<u>20,784,393</u>	<u>100,976,494</u>
EXPENDITURES					
Current operating:					
Flood control administration	51,687,419	128,491	-	6,945,223	58,761,133
Tax administration	440,799	-	-	-	440,799
Capital outlay	3,303,690	1,778,561	-	62,908,136	67,990,387
Debt service:					
Principal retirement	4,235,000	-	14,740,000	-	18,975,000
Interest and fiscal charges	18,302,389	-	2,183,436	-	20,485,825
	<u>77,969,297</u>	<u>1,907,052</u>	<u>16,923,436</u>	<u>69,853,359</u>	<u>166,653,144</u>
Excess (deficiency) of revenues over (under) expenditures	<u>(20,764,609)</u>	<u>7,850,833</u>	<u>(3,693,908)</u>	<u>(49,068,966)</u>	<u>(65,676,650)</u>
OTHER FINANCING SOURCES (USES)					
Transfers in (out) from/to Harris County	22,411,144	(8,058,906)	-	(3,427,347)	10,924,891
Transfers in	-	208,073	-	-	208,073
Transfers out	-	-	-	(208,073)	(208,073)
Commercial paper issued	-	-	-	51,845,000	51,845,000
Sale of capital assets	578,851	-	-	-	578,851
	<u>22,989,995</u>	<u>(7,850,833)</u>	<u>-</u>	<u>48,209,580</u>	<u>63,348,742</u>
Net changes in fund balances	2,225,386	-	(3,693,908)	(859,386)	(2,327,908)
Fund balances, beginning	75,069,723	-	18,934,166	118,501,863	212,505,752
Fund balances, ending	<u>\$ 77,295,109</u>	<u>\$ -</u>	<u>\$ 15,240,258</u>	<u>\$ 117,642,477</u>	<u>\$ 210,177,844</u>

See notes to the financial statements.

**HARRIS COUNTY FLOOD CONTROL DISTRICT
A COMPONENT UNIT OF HARRIS COUNTY, TEXAS
RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS
TO THE STATEMENT OF ACTIVITIES
February 28, 2006**

Net change in fund balances - total governmental funds \$ (2,327,908)

Governmental funds report capital outlays as expenditures. However, in the statement of activities the cost of these assets is allocated over their estimated useful lives and reported as depreciation expense. This is the amount by which capital outlay exceeded depreciation in the current period. 54,310,037

Capital asset donations 22,191,988

Commercial paper proceeds are reported as financing sources in governmental funds and thus contribute to the change in fund balance. In the statement of net assets, however, issuing debt increases long-term liabilities and does not affect the statement of activities. Similarly, repayment of principal is an expenditure in the governmental funds but reduces the liability in the statement of net assets.

Debt issued:		
Commercial paper	\$ (51,845,000)	
Repayments:		
To paying agent for bond principal	<u>18,975,000</u>	
Net adjustment		(32,870,000)

Under the modified accrual basis of accounting used in the governmental funds, expenditures are not recognized for transactions that are not normally paid with expendable available financial resources. In the statement of activities, however, which is presented on the accrual basis, expenses and liabilities are reported regardless of when financial resources are available. In addition, interest on long-term debt is not recognized under the modified accrual basis of accounting until due, rather as it accrues. This adjustment combines the net changes of 6 balances.

Compensated absences	(3,967)	
Amortization of debt premium	2,945,953	
Accretion of discount	(2,171,258)	
Amortization of advanced refunding difference	(83,151)	
Accrued interest on bonds	528,848	
Amortization of deferred charges	<u>(169,459)</u>	
Combined adjustment		1,046,966

Because some revenues will not be collected for several months after the District's fiscal year end, they are not considered "available" revenues and are deferred in the governmental funds. Deferred revenues decreased by this amount in the current period. (1,628,498)

The net effect of sales involving capital assets is to decrease net assets. (45,374)

Change in net assets of governmental activities \$ 40,677,211

See notes to the financial statements.

**HARRIS COUNTY FLOOD CONTROL DISTRICT
A COMPONENT UNIT OF HARRIS COUNTY, TEXAS
STATEMENT OF FIDUCIARY NET ASSETS
AGENCY FUNDS
February 28, 2006
(as restated, Note 11)**

	Army Corps of Engineers Escrow
ASSETS	
Cash and cash equivalents	\$ 1,537,640
Total assets	\$ 1,537,640
 LIABILITIES	
Held for others	\$ 1,537,640
Total liabilities	\$ 1,537,640

See notes to the financial statements.

HARRIS COUNTY FLOOD CONTROL DISTRICT
A COMPONENT UNIT OF HARRIS COUNTY, TEXAS
STATEMENT OF CHANGES IN FIDUCIARY ASSETS AND LIABILITIES
AGENCY FUNDS
For The Year Ended February 28, 2006
(as restated, Note 11)

	<u>Balance</u> <u>March 1, 2005</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance</u> <u>February 28, 2006</u>
<u>Army Corps of Engineers Escrow</u>				
ASSETS				
Cash and cash equivalents	\$ 2,445,640	\$ 72,143	\$ 980,143	\$ 1,537,640
Total Assets	<u>\$ 2,445,640</u>	<u>\$ 72,143</u>	<u>\$ 980,143</u>	<u>\$ 1,537,640</u>
LIABILITIES				
Held for others	\$ 2,445,640	\$ 72,143	\$ 980,143	\$ 1,537,640
Total Liabilities	<u>\$ 2,445,640</u>	<u>\$ 72,143</u>	<u>\$ 980,143</u>	<u>\$ 1,537,640</u>

See notes to the financial statements.

**HARRIS COUNTY FLOOD CONTROL DISTRICT
A COMPONENT UNIT OF HARRIS COUNTY, TEXAS
NOTES TO THE FINANCIAL STATEMENTS
February 28, 2006**

I. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of Harris County Flood Control District (the "District") have been prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP") as applied to governmental units. The Governmental Accounting Standards Board ("GASB") is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The District's significant accounting and reporting policies are described in the following notes.

A. REPORTING ENTITY

These financial statements include all of the operations and activities of the District legal entity, which is a component unit of the reporting entity of Harris County, Texas (the "County"). Financial statements of the District are included as a blended component unit in the County financial statements.

The District was created April 23, 1937 by the Texas Legislature. Commissioners Court, as the elected governing body of the County, is also the statutory governing body of the District. All activities for which the District is financially accountable have been incorporated to form the reporting entity. This report includes the financial statements of the funds required to account for activities, organizations and functions of the District. The criteria for including activities in the District's financial statements are in conformity with GASB Statement No. 14, *The Reporting Entity*.

B. IMPLEMENTATION OF NEW STANDARDS

In the current year, the District implemented the following new standards:

The District implemented GASB Statement No. 40, *Deposits and Investment Risk Disclosures – an amendment of GASB 3* ("GASB 40"). This statement addresses common deposit and investment risks related to credit risks, concentration of credit risk, interest rate risk, and foreign currency risk. As an element of interest rate risk, this statement requires certain disclosures of investments that have fair market values that are highly sensitive to changes in interest rates. Deposit and investment policies related to the risks identified in this statement also are required to be disclosed. Implementation of GASB 40 did not have an impact on the District's financial statements for the year ended February 28, 2006, but required additional disclosures (see Note 2) related to deposits and investment risks.

GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries* ("GASB 42"), establishes standards that define capital asset impairment and specifies how various types of impairment losses will be measured, reported and disclosed. It also clarifies and establishes reporting and disclosure of all insurance recoveries. Implementation of GASB 42 did not have an impact on the District's financial statements for the year ended February 28, 2006.

C. FINANCIAL STATEMENT PRESENTATION, MEASUREMENT FOCUS AND BASIS OF PRESENTATION

Government-wide Statements

Government wide financial statements consist of the Statement of Net Assets and the Statement of Activities. These statements report information on all of the non-fiduciary activities of the District. For the most part, the effect of interfund activity has been removed from these statements. The District reports only governmental activities, which normally are supported by taxes and intergovernmental revenues.

The government-wide financial statements are prepared using the economic resources measurement focus

HARRIS COUNTY FLOOD CONTROL DISTRICT
A COMPONENT UNIT OF HARRIS COUNTY, TEXAS
NOTES TO THE FINANCIAL STATEMENTS
February 28, 2006

and the accrual basis of accounting. Under this measurement focus, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of the timing of cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

The Statement of Activities demonstrates the degree to which the direct expenses of the District's programs are offset by those programs' revenues. Program revenues include 1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by the program and 2) grants and contributions that are restricted to meeting the operational and/or capital requirements of a particular program. Program revenues are generated from flood control activities. Taxes and other items not included among program revenues are reported instead as general revenues.

Fund-level Statements

All governmental funds use the modified accrual basis of accounting. Under the modified accrual basis of accounting, revenues are recognized when susceptible to accrual (i.e., when they become both measurable and available). "Measurable" means the amount of the transaction can be determined and "available" means collectible within the current period or soon enough thereafter to be used to pay liabilities of the current period. The District considers property taxes and other revenues as available if they are collected within 60 days after year-end. Expenditures are recorded when the related fund liability is incurred. Principal and interest on governmental long-term debt are recorded as fund liabilities when due or when amounts have been accumulated in the debt service fund for payments to be made early in the following year. Encumbrances are used during the year and any unliquidated items are reported at year-end as a reservation of fund balance. Grant and entitlement revenues are also susceptible to accrual. These funds are accounted for on a spending "financial flow" measurement focus. This means that only current assets and current liabilities are generally included on their balance sheets. Their reported fund balance (net current assets) is considered a measure of "available spendable resources." Governmental fund operating statements present increases (revenues and other financing sources) and decreases (expenditures and other financing uses) in net current assets. Accordingly, they are said to present a summary of sources and uses of "available spendable resources" during a period.

Fiduciary funds, including agency funds, are accounted for using the accrual basis of accounting. This means that all assets and liabilities (whether current or non-current) associated with their activity are included in the funds' statement of net assets. The agency funds are custodial in nature and involve no measurement of results of operations.

The accounts of the District are organized on the basis of funds, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues and expenditures. Government resources are allocated to and accounted for in individual funds based upon the purposes for which they are to be spent and the means by which spending activities are controlled.

Funds are generally classified into three categories: Governmental, Proprietary, and Fiduciary. The District has four governmental funds and one fiduciary fund and reports all funds as major funds. The District's funds are comprised of:

GOVERNMENTAL FUNDS

Operations and Maintenance (General) Fund - used to account for all revenues and expenditures, not accounted for in other funds, relating to general operations.

**HARRIS COUNTY FLOOD CONTROL DISTRICT
A COMPONENT UNIT OF HARRIS COUNTY, TEXAS
NOTES TO THE FINANCIAL STATEMENTS
February 28, 2006**

Special Revenue Grants - used to account for grant programs applicable to the District.

Debt Service Fund - used to account for payment of principal and interest on the District's property tax bonds.

Capital Projects Fund - used to account for capital improvements and acquisitions which are financed from the District's general obligation bonds and other revenue sources.

FIDUCIARY FUND - used to report assets held in an agency capacity for others and therefore cannot be used to support the government's own programs. The District reports one agency fund.

D. BUDGETS

The County adheres to the following timetable for consideration and adoption of the annual operating budget for the Flood Control Operations and Maintenance (General) Fund and the Debt Service Funds:

- Departmental annual budget requests are submitted by the Department or Agency Head to the County Budget Officer during the third quarter of the fiscal year for the upcoming fiscal year to begin March 1.
- The County Auditor must prepare an estimate of available resources for the upcoming fiscal year.
- The County Budget Officer prepares the proposed annual operating budget to be presented to Commissioners Court for their consideration. The budget represents the financial plan for the new fiscal year.
- Public hearings are held on the proposed budget.
- Commissioners Court must adopt an annual operating budget by a majority vote of Commissioners Court before April 1. The adopted budget must be balanced; that is, available resources must be sufficient to support annual appropriations.
- Annual budgets are legally adopted for the General Fund and Debt Service Fund. Budgets for Capital Projects are established on a project basis.
- The fund is the legal level of budgetary control. Commissioners Court approval is necessary to transfer appropriations between departments. Transfers may not increase the total budget.
- Commissioners Court may approve expenditures as an amendment to the budget in an emergency situation that could not have been foreseen at the time of the original budget was approved.
- Commissioners Court may adopt a supplemental budget for the limited purpose of spending proceeds of the sale of bonds or other obligations to be issued against future revenues and public or private grant or aid money for its intended purpose.
- The County Auditor shall certify to the Commissioners Court the receipt of all public or private grant or aid money that is available for disbursement in a fiscal year, but not included in the budget for the fiscal year.

**HARRIS COUNTY FLOOD CONTROL DISTRICT
A COMPONENT UNIT OF HARRIS COUNTY, TEXAS
NOTES TO THE FINANCIAL STATEMENTS
February 28, 2006**

- Appropriations lapse at year-end.
- Budgets are prepared on a cash basis (budget basis) which differs from a GAAP basis.

E. DEPOSITS AND INVESTMENTS

Cash and cash equivalents include amounts in demand deposits as well as short-term investments (i.e. with original maturity of 90 days or less). All investments are recorded at fair value, as required by GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, based upon quoted market prices, with the difference between the purchase price and market price being recorded as earnings on investments.

F. INTERFUND TRANSACTIONS

During the course of normal operations, the District has many transactions between funds. The accompanying financial statements reflect as transfers the resources provided and expenditures used to provide services, construct assets and meet debt service requirements.

G. CAPITAL ASSETS

Capital assets include land, buildings, improvements other than buildings, equipment, construction in progress, and flood control infrastructure that are used in the District's operations and benefit more than a single fiscal year. Infrastructure assets are long-lived assets that are generally stationary in nature and can typically be preserved for a significantly greater number of years than other capital assets. Infrastructure assets of the District include flood control channels, storm sewers, and related right of way.

Capital assets of the District are defined as assets with individual costs of \$5,000 or more and estimated useful lives in excess of one year. Exceptions to the \$5,000 capitalization threshold are as follows: it is the County's policy to capitalize all land and easements, regardless of the historical cost. The threshold for capitalizing buildings and building improvements is \$100,000. The capitalization threshold for infrastructure ranges from \$25,000 to \$250,000, depending on the type of infrastructure asset.

All capital assets are stated at historical cost or estimated historical cost if actual cost is not available. Donated fixed assets are stated at their estimated fair value on the date donated.

It is the County's policy not to capitalize interest on construction for governmental capital assets. Capital assets are depreciated in the government-wide financial statements using the straight-line method over the following useful lives:

<u>Asset</u>	<u>Years</u>
Buildings	45
Equipment	3-20
Flood Control Infrastructure:	
Flood control channels	25-75
Storm sewers	30-75

H. NET ASSETS AND FUND BALANCES

NET ASSETS CLASSIFICATIONS

Net assets in the government-wide financial statements are classified in three categories: 1) Net assets invested in capital assets, net of related debt, 2) Restricted net assets, and 3) Unrestricted net assets. Net

HARRIS COUNTY FLOOD CONTROL DISTRICT
A COMPONENT UNIT OF HARRIS COUNTY, TEXAS
NOTES TO THE FINANCIAL STATEMENTS
February 28, 2006

assets are shown as restricted if constraints placed on use are either (1) externally imposed by creditors, grantors, contributors, or laws or regulations of other governments or (2) imposed by law through constitutional provisions or enabling legislation. The District's restricted net assets are restricted for debt service and capital projects.

RESERVATIONS AND DESIGNATIONS

In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for a specific purpose. Designations of fund balance represent tentative management plans that are subject to change.

I. COMPENSATED ABSENCES

Accumulated compensatory time, vacation and sick leave expected to be liquidated with expendable available financial resources is reported as an expenditure in the respective Governmental Fund. Accumulated compensated absences not expected to be liquidated with expendable available resources are reported as long-term liabilities in the government-wide financial statements.

Employees accrue 9.75 days of sick leave per year. Sick leave benefits are recognized as they are used by the employees. Employees may accumulate up to 480 hours of sick leave. Unused sick leave benefits are not paid at termination. Employees with more than one year of service accrue from two to four weeks of vacation annually, depending on years of service. Unused vacation benefits lapse at calendar year-end except for exempt employees who may convert up to 40 hours of such benefits to compensatory time, subject to a 240 hour maximum. Upon termination, employees are paid unpaid vacation benefits accrued during the year.

Non-exempt employees earn compensatory time at one and one-half times their full pay times the excess of 40 hours per week worked. The compensatory time balance for non-exempt employees may not exceed 240 hours. Hours in excess of the 240 hours maximum must be paid to the non-exempt employee at the rate of one and a half times the regular rate. Upon termination, non-exempt employees will be paid for compensatory time at their wage rate at time of termination. Exempt employees earn compensatory time at their regular rate of pay for hours worked in excess of 40 hours a week. Exempt employees can accumulate up to 240 hours of compensatory time. Upon termination, exempt employees are paid one-half of the compensatory time earned at the wage rate at time of termination. Compensatory time is carried forward indefinitely.

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 the 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.

2. DEPOSITS AND INVESTMENTS

Deposits: Chapter 2257 of the Texas Government Code is known as the Public Funds Collateral Act. This act provides guidelines for the amount of collateral that is required to secure the deposit of public funds. Federal Depository Insurance (FDIC) is available for funds deposited at any one financial institution up to a

HARRIS COUNTY FLOOD CONTROL DISTRICT
A COMPONENT UNIT OF HARRIS COUNTY, TEXAS
NOTES TO THE FINANCIAL STATEMENTS
February 28, 2006

maximum of \$100,000 each for demand deposits, time and savings deposits, and deposits pursuant to indenture. The Public Funds Collateral Act requires that the deposit of public funds be collateralized in an amount not less than the total deposit, reduced by the amount of FDIC insurance available.

The custodial credit risk for deposits is the risk that the District will not be able to recover deposits that are in the possession of an outside party. Deposits are exposed to custodial credit risk if they are not insured or collateralized. At February 28, 2006, the carrying amount of the District's demand and time deposits was \$1,887,371 and the balance per various financial institutions was \$1,537,690. The District's deposits are not exposed to custodial credit risk since all deposits are either covered by FDIC insurance or collateralized with securities held by the District or its agent in the District's name, in accordance with the Public Funds Collateral Act.

Investments: Chapter 2256 of the Texas Government Code is known as the Public Funds Investment Act. This act authorizes the District to invest its funds pursuant to a written investment policy which primarily emphasizes the safety of principal and liquidity, addresses investment diversification, yield, and maturity.

The District follows the guidelines established by the Harris County Investment policy. The Harris County Investment policy is reviewed and approved annually by Commissioners Court. The Investment Policy includes a list of authorized investment instruments, a maximum allowable stated maturity by fund type, and the maximum weighted average maturity of the overall portfolio. Guidelines for diversification and risk tolerance are also detailed within the policy. Additionally, the policy includes specific investment strategies for fund groups that address each group's investment options and describes the priorities for suitable investments.

AUTHORIZED INVESTMENTS

Harris County funds may be invested in the following investment instruments provided that such instruments meet the guidelines of the investment policy:

1. Obligations of the US or its agencies and instrumentalities.
2. Direct obligation of the State of Texas or its agencies and instrumentalities.
3. Collateralized mortgage obligations directly issued by a federal agency or instrumentality of the United States, the underlying security for which is guaranteed by an agency or instrumentality of the United States, with a stated final maturity of 10 years or less.
4. Other obligations the principal and interest of which are unconditionally guaranteed or insured by or backed by the full faith and credit of this state or the US.
5. Obligations of states, agencies, counties, cities, and other political subdivisions of any state rated and to investment quality by a nationally recognized investment rating firm not less than AA or its equivalent.
6. Certificates of deposit issued by a state or national bank domiciled in this state or a savings and loan association domiciled in this state that are guaranteed or insured by the FDIC or secured by authorized investments that have a market value of not less than the principal amount of the certificates.
7. Fully collateralized repurchase agreements that the County has obtained a signed master repurchase agreement with the company into which the agreement is entered, as authorized by the Public Funds Investment Act.
8. Commercial paper with a stated maturity of 270 days or fewer from the date of issuance as authorized by the Public Funds Investment Act.
9. No-load money market mutual funds regulated by the SEC, with a dollar-weighted average stated maturity of 90 days or fewer and which include in their investment objectives the maintenance of a stable

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net asset value of \$1 per share as authorized by the Public Funds Investment Act.

- 10. Guaranteed Investment Contracts as authorized by the Public Funds Investment Act.
- 11. Public Funds Investment Pools as authorized by the Investment Act.

Summary of Cash and Investments

The District's cash and investments are stated at fair value. The following is a summary of cash and investments held by the District at February 28, 2006.

	Governmental Funds	Fiduciary Funds	Total
Cash and Cash Equivalents	\$ 16,214,814	\$ 1,537,640	\$ 17,752,454
Restricted Cash and Cash Equivalents	1,862,220	-	1,862,220
Investments	192,454,417	-	192,454,417
Total Cash & Investments	\$ 210,531,451	\$ 1,537,640	\$ 212,069,091

The table below indicates the fair value and maturity value of the District's investments as of February 28, 2006, summarized by security type. Also demonstrated are the percentage of total portfolio and the weighted average maturity in years for each summarized security type.

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<u>Security</u>	<u>Fair Value</u>	<u>Percentage of Portfolio</u>	<u>Maturity Amount</u>	<u>Weighted Avg Modified Duration (Years)</u>	<u>Credit Rating S&P/ Moody's</u>
<i>US Agency Notes</i>					
FFCB	\$ 5,926,141	2.82%	\$ 6,000,000	0.020	AAA/Aaa
FHLB	75,671,656	36.00%	76,500,000	0.281	AAA/Aaa
FHLMC	42,715,457	20.32%	43,485,000	0.126	AAA/Aaa
FNMA	33,288,636	15.84%	33,800,000	0.164	AAA/Aaa
<i>Commercial Paper</i>					
AGFC	12,752,408	6.07%	12,880,000	0.012	A-1/P-1
AMEX	1,612,671	0.77%	1,620,000	0.001	A-1/P-1
FCAR	16,931,440	8.06%	17,040,000	0.010	A-1+/P-1
GECC	5,253,385	2.50%	5,300,000	0.004	A-1+/P-1
<i>Local Governments</i>					
Dover, Delaware Ele	978,694	0.47%	1,000,000	0.006	AAA/Aaa
Indiana Bd Bk	1,627,581	0.77%	1,640,000	0.003	AAA/Aaa
Los Angeles, California	3,961,478	1.88%	4,000,000	0.006	AAA/Aaa
Oregon St Loc	669,025	0.32%	680,000	0.004	AAA/Aaa
Philadelphia, Pennsylvania	1,145,367	0.54%	1,150,000	0.002	AAA/Aaa
San Antonio, Texas	487,699	0.23%	500,000	0.002	AAA/Aaa
State of Texas	2,788,428	1.33%	2,860,000	0.016	AA/Aa2
<i>Money Market Funds</i>					
AIM STIT Treasury Portfolio	2,956,697	1.41%	2,956,697	N/A	AAA/Am/Aaa
Fidelity Instutional - Tax Exempt	1,414,957	0.67%	1,414,957	N/A	AAA/Am/Aaa
Total Investments	210,181,720	100.00%	\$ 212,826,654	0.657	
<i>Demand and Time Deposits</i>	1,887,371				
Total Cash & Investments	<u><u>\$ 212,069,091</u></u>				

RISK DISCLOSURES

Interest Rate Risk: All investments carry the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment the greater the sensitivity of its fair value to changes in market interest rates. One of the ways that the District manages its exposure to interest rate risk is by purchasing a combination of shorter and longer term investments and by matching cash flows from maturities so that a portion of the portfolio is maturing evenly over time as necessary to provide the cash flow and liquidity needed for operations.

According to the County investment policy, no more than 25% of the portfolio, excluding those investments held for future capital expenditures, debt service payments, bond fund reserve accounts and capitalized interest funds, may be invested beyond 24 months. Additionally at least 15% of the portfolio, with the previous exceptions, is invested in overnight instruments or in marketable securities which can be sold to raise cash within one day's notice. Overall, the average maturity of the portfolio, with the previous exceptions, shall not exceed two years. As of February 28, 2006, the District was in compliance with all of these guidelines to manage interest rate risk.

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Credit Risk and Concentration of Credit Risk: Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Concentration of credit risk is the risk of loss attributed to the magnitude of an investment in a single issuer. The District mitigates these risks by emphasizing the importance of a diversified portfolio. All funds must be sufficiently diversified to eliminate the risk of loss resulting from over-concentration of assets in a specific maturity, a specific issuer, or a specific class of securities. In particular, no more than 50% of the overall portfolio may be invested in time deposits, including certificates of deposit, of a single issuer. Concentration by issuer for other investment instruments is not specifically addressed in the investment policy. However, the policy does specify that acceptable investment instruments must have high quality credit ratings and, consequently, risk is minimal.

The County's investment policy establishes minimum acceptable credit ratings for certain investment instruments. Securities of states, agencies, counties, cities and other political subdivisions must be rated as to investment quality by a nationally recognized investment rating firm as AA or its equivalent. Money market mutual funds and public funds investment pools must be rated Aaa by Moody's Investor Rating Service.

Custodial Credit Risk: Investments are exposed to custodial credit risk if the investments are uninsured, are not registered in the District's name and are held by the counterparty. In the event of the failure of the counterparty, the District may not be able to recover the value of its investments that are held by the counterparty. As of February 28, 2006, all of the District's investments are held in the District's name.

Foreign Currency Risk: Foreign currency risk is the risk that fluctuations in the exchange rate will adversely affect the value of investments denominated in a currency other than the US dollar. The County Investment Policy does not list securities denominated in a foreign currency among the authorized investment instruments. Consequently, the District is not exposed to foreign currency risk

FUND INVESTMENT CONSIDERATIONS

The Investment Policy outlines specific investment strategies for each fund or group of funds identified on the District's financial statements. The two investment strategies employed by the District are the Matching Approach and the Barbell Approach. The Matching Approach is an investment method that matches maturing investments with disbursements. Matching requires an accurate forecast of disbursement requirements. The Barbell Approach is an investment method where maturities are concentrated at two points, one at the short end of the investment horizon and the other at the long end. Additionally, the Investment Policy specifies average investment durations for each fund type, excluding Pooled Investments. Specific guidelines have not been established for Pooled Investments, but the same standards that were developed for the General Fund are also applicable to Pooled Investments. The investment strategies and maturity criteria are outlined in the following table.

Fund Type	Investment Strategy	Avg Investment Duration Per Policy (Days)	Maturity Amount	Average Remaining Days To Maturity
Pooled Investments	Matching	720	\$ 104,530,000	246
Debt Service Funds	Matching	270	14,525,000	177
Capital Project Funds	Matching	1,080	89,400,000	309
Money Market Mutual Funds	N/A	N/A	4,371,654	N/A
			<u>\$ 212,826,654</u>	

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3. PROPERTY TAXES

Property taxes for the District are levied each October 1 on the assessed value as of the preceding January 1 for all taxable real and personal property. On January 1, at the time of assessment, an enforceable lien is attached to the property for property taxes. Appraised values are determined by the Harris County Appraisal District (the "Appraisal District") equal to 100% of the appraised market value as required by the State Property Tax Code. Real property must be appraised at least every four years. Taxpayers and taxing units may challenge appraisals of the Appraisal District through various appeals and, if necessary, legal action.

The District is permitted by law to levy a tax rate up to \$.30 per \$100 of taxable valuation. There is no limitation on the tax rate which may be set for debt service within the \$.30/\$100 valuation. The tax rate for maintenance is limited to the rate as may from time to time be approved by the voters of the District. The maximum tax rate for maintenance is \$.15 per \$100 of taxable valuation. The County is responsible for setting the tax rate for the District. The County adopted the following tax rates on behalf of the District for the 2005 tax year, per \$100 of taxable valuation:

	Operations and Maintenance <u>(General)</u>	<u>Debt</u> <u>Service</u>	<u>Total</u>
Flood Control District	\$0.02733	\$0.00589	\$0.03322

Property tax receivables of \$2,566,585 as of February 28, 2006 are reported net of an allowance for uncollectible taxes of \$20,063,912 and includes penalties and interest of \$8,967,390.

4. INTERFUND TRANSFERS

The following is a summary of the District's transfers for the year ended February 28, 2006:

	Transfers In:
	Grants Fund
Transfers Out:	
Capital Projects Fund	<u>\$ 208,073</u>
TOTAL	<u><u>\$ 208,073</u></u>

The transfers are routine in nature. Transfers between individual governmental funds are eliminated in the government-wide financial statements.

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5. CAPITAL ASSETS

Capital assets transactions are summarized as follows:

	Balance				Balance
	March 1, 2005	Additions	Disposals	Transfers	February 28, 2006
Governmental Activities:					
Land	\$ 1,342,755,732	\$ 26,561,855	\$ (25,000)	\$ -	\$ 1,369,292,587
Construction in progress	132,523,608	62,984,656	-	(37,454,690)	158,053,574
Total capital assets not depreciated	<u>1,475,279,340</u>	<u>89,546,511</u>	<u>(25,000)</u>	<u>(37,454,690)</u>	<u>1,527,346,161</u>
Buildings	3,330,706	-	-	-	3,330,706
Equipment	7,117,902	668,437	(150,952)	-	7,635,387
Flood control projects	396,173,803	-	-	37,454,690	433,628,493
	<u>406,622,411</u>	<u>668,437</u>	<u>(150,952)</u>	<u>37,454,690</u>	<u>444,594,586</u>
Less accumulated depreciation for:					
Buildings	(1,254,079)	(72,380)	-	-	(1,326,459)
Equipment	(3,500,999)	(965,365)	130,578	-	(4,335,786)
Flood control projects	(157,415,509)	(12,675,178)	-	-	(170,090,687)
	<u>(162,170,587)</u>	<u>(13,712,923)</u>	<u>130,578</u>	<u>-</u>	<u>(175,752,932)</u>
Total capital assets being depreciated, net	<u>244,451,824</u>	<u>(13,044,486)</u>	<u>(20,374)</u>	<u>37,454,690</u>	<u>268,841,654</u>
Governmental activities capital assets, net	<u>\$ 1,719,731,164</u>	<u>\$ 76,502,025</u>	<u>\$ (45,374)</u>	<u>\$ -</u>	<u>\$ 1,796,187,815</u>

Depreciation expense was charged to the Flood Control function of the District for \$13,712,923.

6. LONG-TERM DEBT

Bonded debt of the District consists of various issues of General Obligation Bonds, which are direct obligations of the District with the District's full faith and credit pledged towards the payment of these obligations. Debt service on these bonds is paid from the receipts of a separate limited ad valorem tax.

The changes in the District's Governmental Long-Term Debt for fiscal year 2005-2006 were as follows:

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	Outstanding March 1, 2005	Increase	Decrease	Outstanding February 28, 2006	Amount Due Within One Year
Governmental Activities:					
Total Bonds Payable - Principal	\$ 385,229,985	\$ -	\$(18,975,000)	\$ 366,254,985	\$ 17,070,000
Unamortized Premium, Series 1993	3,842,149	-	(829,196)	3,012,953	-
Unamortized Premium, Series 2002	647,605	-	(138,655)	508,950	-
Unamortized Premium, Series 2003A	689,856	-	(480,092)	209,764	-
Unamortized Premium, Series 2003B	9,225,619	-	(412,658)	8,812,961	-
Unamortized Premium, Series 2004A	10,766,130	-	(1,085,352)	9,680,778	-
Accretion of Discount - Capital					
Appreciation Bonds: Series 1993	13,738,745	2,171,258	-	15,910,003	-
Bond Refunding Loss, Series 2002	(153,173)	-	49,773	(103,400)	-
Bond Refunding Loss, Series 2003A	(353,245)	-	33,378	(319,867)	-
Total Bonds Payable	<u>423,633,671</u>	<u>2,171,258</u>	<u>(21,837,802)</u>	<u>403,967,127</u>	<u>17,070,000</u>
Commercial Paper Payable	26,580,000	51,845,000	-	78,425,000	7,129,545
Compensatory Time Payable	336,229	272,951	(268,984)	340,196	265,353
TOTAL	<u>\$ 450,549,900</u>	<u>\$ 54,289,209</u>	<u>\$(22,106,786)</u>	<u>\$ 482,732,323</u>	<u>\$ 24,464,898</u>

Historically, the Debt Service fund has been used to liquidate bonded debt and the General Fund has been used to liquidate other long-term liabilities.

A. OUTSTANDING BONDED DEBT

	Interest Rates (%)	Date Series		Balance February 28, 2006
		Issued	Matures	
Refunding Series 1993 - CAB	5.40-5.60	1993	2011	\$ 6,474,985
Refunding Series 2002	3.00-5.50	2002	2014	9,985,000
Refunding Series 2003-A	3.00-6.00	2003	2015	22,400,000
Refunding Series 2003-B	5.00-5.25	2003	2023	191,765,000
Refunding Series 2004-B	3.00-5.25	2004	2024	135,630,000
TOTAL				<u>\$ 366,254,985</u>

B. DEBT SERVICE REQUIREMENTS

The debt service requirements to maturity for the bonds are summarized as follows:

Fiscal year	Principal	Capital	Principal	Interest	Total
	At 2/28/2006	Appreciation Bonds	Value At Maturity		
2007	\$ 17,070,000	\$ -	\$ 17,070,000	\$ 18,057,525	\$ 35,127,525
2008	8,755,287	6,729,007	15,484,294	25,682,457	41,166,751
2009	7,908,864	4,145,284	12,054,148	22,937,380	34,991,528
2010	8,667,889	2,883,634	11,551,523	21,462,255	33,013,778
2011	8,318,921	1,589,903	9,908,824	19,409,711	29,318,535
2012-2016	43,904,024	562,175	44,466,199	77,561,841	122,028,040
2017-2021	118,350,000	-	118,350,000	62,721,839	181,071,839
2022-2026	153,280,000	-	153,280,000	16,897,731	170,177,731
	<u>\$ 366,254,985</u>	<u>\$ 15,910,003</u>	<u>\$ 382,164,988</u>	<u>\$ 264,730,739</u>	<u>\$ 646,895,727</u>

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C. UNISSUED AUTHORIZED BONDS

As of February 28, 2006, the District has voter authorization to issue \$95,000,000 of additional property tax bonds.

D. REFUNDING OF DEBT

The Flood Control District did not issue any refunding debt in the current year.

E. COMMERCIAL PAPER

On August 21, 2001, Commissioners Court authorized a \$200,000,000 commercial paper program designated as the Harris County Flood Control District Contract Tax Commercial Paper Notes, Series F ("Series F Notes") to fund projects identified in an agreement between the County and the Flood Control District ("Flood Contract") and refinance, refund, and renew the notes themselves and fund issuance costs. The estimated cost of projects anticipated under the Flood Contract is \$718,830,000.

The terms of the Series F Notes require the notes to be issued with a maturity of 270 days or less and allow for interest up to the maximum rate allowable under Chapter 1204 of the Texas Government Code, currently 15%. The notes will be dated as of the date of issuance with a maximum maturity date of September 1, 2031. Payment of the principal and interest on the Series F Notes and all expenditures associated with the issuing and paying agent, the dealer and the credit provider is secured by a pledge and lien on the payments to be received by the Flood Control District from the County under the Flood Contract. Under the Flood Contract, the Flood Control District pays all costs relating to the County flood control projects and issues notes to provide the funding for such projects.

The County's commitment under the Flood Contract is the payment to the Flood Control District of amounts necessary for the principal and/or interest due; the fees and expenditures of the issuing and paying agent, the dealer, and the credit provider; amounts related to any special or contingency funds or accounts for the notes; and any amounts to restore deficiencies in such funds or accounts. The County's payment obligation is secured by a levy and pledge of a portion of the County's ad valorem taxes which extends until all obligations under the Series F Notes, including any obligations to refund the notes, are no longer outstanding. During the term of the Flood Contract, the County is required to levy taxes computed at a tax rate sufficient to provide the funds required to make the annual payments and to provide and maintain a sinking fund adequate for such amounts as they become due. Commissioners Court issued an order whereby the sinking fund may never be less than 2% of the County's outstanding indebtedness under the Flood Contract at the time of the tax levy. In setting the tax rate, the County may consider all sources of funding lawfully available or that are to be available including the credit agreement entered into for the Series F Notes, discussed below. Because of the allocation of other available funds sufficient to satisfy the annual amount due under the Flood Contract, the County has not been required to set a tax rate related to the 2% limitation. Based on the County's outstanding indebtedness as of February 28, 2006 (exclusive of Flood Control District debt), this amount required under the 2% limitation is estimated to be \$1,568,500.

Under a dealer agreement between the Flood Control District and Morgan Stanley & Co. Incorporated, the Series F Notes are issued in denominations of a minimum of \$100,000 and integral multiples of \$1,000 thereafter and may bear interest or be sold at a discount. The dealer agreement does not provide for extension, renewal, or automatic rollover of the notes upon maturity. In consideration for the services of the dealer, the Flood Control District is obligated to make quarterly payments equaling .05% of the daily outstanding principal amount of issued Series F Notes. The paying agent for the Series F Notes is Deutsche Bank for which it receives an annual administration fee of \$2,500 and per transaction

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fees ranging from \$10 to \$40.

The Series F Notes are also secured through an irrevocable, direct-pay, transferable letter of credit between the Flood Control District and the New York branch of Landesbank Hessen-Thüringen Girozentrale. The amount of the letter of credit totals \$214,794,521. This total includes the principal amount of the notes (\$200,000,000) and interest of \$14,794,521 calculated as 270 days at an assumed per annum rate of 10% and a 365-day year. The term of the letter of credit expires August 1, 2007 and is subject to extension of up to 364 days per request. The letter of credit also provides for the establishment of loans with maturity dates ranging from three to four years depending on the earliest of several anniversary dates. The interest rate on such loans may not exceed the maximum rate allowed by law, currently 15%. The principal portion of the loans is repayable in equal quarterly installments and the interest quarterly. Under the terms of the letter of credit, the Flood Control District is charged a quarterly fee, based on the daily average amount of the outstanding draws against the letter of credit, presently at .12%. This fee is dependent on the County's parity debt rating at the time. In addition, there are fixed transactional fees ranging from \$12 to \$1,000.

Assuming that as of February 28, 2006, loans existed for the full \$78,425,000 principal outstanding on Series F Notes, the following table is representative of the debt service requirements based on the average interest rate for the quarter ending February 28, 2006 over the next four years:

Fiscal Year	Principal	Interest	Total
2007	\$ 7,129,545	\$ 5,963,568	\$ 13,093,113
2008	28,518,180	9,216,423	37,734,603
2009	28,518,180	4,879,283	33,397,463
2010	14,259,095	813,214	15,072,309
TOTAL	\$ 78,425,000	\$ 20,872,488	\$ 99,297,488

F. ARBITRAGE REBATE LIABILITY

The Tax Reform Act of 1986 established regulations for the rebate to the federal government of arbitrage earnings on certain local government bonds issued after December 31, 1985, and all local governmental bonds issued after August 31, 1986. Issuing governments must calculate any rebate due and remit the amount due at least every five years. There were no arbitrage rebate payments made during fiscal year 2006. As of February 28, 2006 there were no estimated liabilities for arbitrage rebate on governmental debt. The Debt Service Funds have typically been used to liquidate arbitrage liabilities in previous year.

7. RETIREMENT PLAN

Plan Description

The District, a component unit of Harris County, provides retirement, disability, and death benefits for all of its full-time employees through a non-traditional defined benefit pension plan in the statewide Texas County and District Retirement System ("TCDRS"). The Board of Trustees of TCDRS is responsible for the administration of the statewide agent multiple-employer public employee retirement system consisting of 553 non-traditional defined benefit pension plans. TCDRS in the aggregate issues a comprehensive annual financial report ("CAFR") on a calendar year basis. The CAFR is available upon written request from the TCRDS Board of Trustees at P.O. Box 2034, Austin, Texas 78768-2034.

Under the state law governing TCDRS since 1991, the District has had the option of selecting the plan of benefits to provide in the future, while at the same time considering the level of the employer contribution rate

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required to adequately finance the plan. Effective January 1, 1995, the District adopted an annually determined contribution rate plan, for which the employer contribution rate is actuarially determined as a part of the annual actuarial valuation. The rate, applicable for a calendar year, consists of the normal cost contribution rate plus the rate required to amortize the unfunded actuarial liability over the remainder of the plan's 25-year amortization period which began January 1, 1995 using the entry age actuarial cost method. Monthly contributions by the District are based on the covered payroll and the employer contribution rate in effect. The contribution rate for 2006 is 9.81%. The contribution rates for 2005 and 2004 were 10.05% and 10.53% respectively.

The plan provisions are adopted by the Commissioners Court of the County, within the options available in the state statutes governing TCDRS ("TCDRS Act"). Members can retire at ages 60 and above with 8 or more years of service or with 30 years of service regardless of age or when the sum of their age and years of service equals 75 or more. Members are vested after eight years but must leave their accumulated contributions in the plan to receive any employer-financed benefit. Members who withdraw their personal contributions in a lump sum are not entitled to any amounts contributed by the District.

Benefit amounts are determined by the sum of the employee's contributions to the plan, with interest and employer-financed monetary credits. The level of these monetary credits is adopted by Commissioners Court, within the actuarial constraints imposed by the TCDRS Act so that the resulting benefits can be expected to be adequately financed by the employer's commitment to contribute. At retirement, death, or disability, the benefit is calculated by converting the sum of the employee's accumulated contributions and the employer-financed monetary credits to a monthly annuity using annuity purchase rates prescribed by the TCDRS Act.

Funding Policy

The District has elected the annually determined contribution rate plan provisions of the TCDRS Act. The plan is funded by monthly contributions from both employee members and the District based on the covered payroll of employee members. Under the TCDRS Act, the contribution rate of the District is actuarially determined annually. The District contributed using actuarially determined rate of 10.05% for the months of the calendar year in 2005, and 9.81% for the months of the calendar year in 2006.

The contribution rate payable by the employee members for 2005 and 2006 is the rate of 7% as adopted by Commissioners Court. The employee contribution rate and the employer contribution rate may be changed by Commissioners Court, within the options available in the TCDRS Act.

Annual Pension Cost

For the County's accounting year ending February 28, 2006, the annual pension cost for the TCDRS plan for its employees, including the District, was \$60,990,625, and the actual contributions for the District were \$1,546,672.

The annual required contributions were actuarially determined as a percent of the covered payroll of the participating employees, and were in compliance with GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employees*, parameters based on the actuarial valuations as of December 31, 2004 and December 31, 2005, which were the basis for determining the contribution rates for calendar years 2005 and 2006. The December 31, 2005 actuarial valuation is the most recent valuation.

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Actuarial Valuation Method			
Actuarial Valuation Date	12/31/03	12/31/04	12/31/05
Actuarial Cost Method	Entry Age	Entry Age	Entry Age
Amortization Method	Level percentage of payroll, open	Level percentage of payroll, open	Level percentage of payroll, open
Amortization period in years	20	20	20
Asset Valuation Method	Long-term appreciation with adjustments	Long-term appreciation with adjustments	Long-term appreciation with adjustments
Actuarial Assumption			
Investment return (1)	8.0 %	8.0 %	8.0 %
Projected Salary Increases (1)	5.5 %	5.5 %	5.3 %
Inflation	3.5 %	3.5 %	3.5 %
Cost of Living Adjustments	0.0%	0.0%	0.0%
(1) Includes inflation at the stated rate.			

Harris County Trend Information			
Accounting Year Ending	Annual Pension Cost	Percentage of APC Contributed	Net Pension Obligation
2/28/06	\$ 60,990,625	100%	-
2/28/05	\$ 60,824,272	100%	-
2/29/04	\$ 56,659,405	100%	-

Schedule of Funding			
Actuarial Valuation Date	12/31/03	12/31/04	12/31/05
Actuarial Value of Assets	\$1,640,964,686	\$1,789,864,440	\$1,950,248,224
Actuarial Accrued Liability (AAL)	\$1,848,669,873	\$2,005,039,645	\$2,157,877,524
Unfunded Actuarial Accrued Liability (UAAL)	\$ 207,705,187	\$ 215,175,205	\$ 207,629,300
Funded Ratio	88.76%	89.27%	90.38%
Annual Covered Payroll (Actuarial)	\$ 570,304,250	\$ 623,386,613	\$ 631,353,087
UAAL as Percentage of Covered Payroll	36.42%	34.52%	32.89%

8. POST EMPLOYMENT BENEFITS

In addition to providing pension benefits described herein, the District provides certain retirement health care and life insurance benefits for retired employees. In accordance with the Personnel Regulations adopted by Commissioners Court, all District employees may become eligible for these benefits after meeting the service and retirement age requirements of the District's retirement plan. These requirements, which were modified effective January 1, 1996, require 30 years of service, or 8 years of service and 60 years of age, or years of service plus age equal to 75 or more. The District recognizes expenditures for retirement benefits as incurred, which during fiscal year 2006 totaled \$1,010,128. Presently, 171 retirees qualified for retirement benefits.

9. COMMITMENTS AND CONTINGENT LIABILITIES

LITIGATION

The District is involved in lawsuits and other claims in the ordinary course of operations. Although the outcome of such lawsuits and other claims is not presently determinable, the resolution of these matters is not

**HARRIS COUNTY FLOOD CONTROL DISTRICT
A COMPONENT UNIT OF HARRIS COUNTY, TEXAS
NOTES TO THE FINANCIAL STATEMENTS
February 28, 2006**

expected to have a material effect on the financial condition of the District.

CONSTRUCTION COMMITMENTS

The District has commitments under various contracts in connection with the construction of flood control facilities, buildings, and projects of \$60,223,934.

10. RISK MANAGEMENT

The District's risk-of-loss exposures include exposure to liability and accidental loss of real and personal property as well as human resources. District operations involve a variety of high-risk activities including, but not limited to, construction and maintenance activities. The County's Office of Human Resources & Risk Management is responsible for identifying, evaluating, and managing the District's risk in order to reduce the exposure from liability and accidental loss of property and human resources. The District is treated as a County department by the County's Risk Management Office and is assessed premiums and charges similar to other County departments.

The District is covered by the Harris County workers' compensation program. The County is self-insured for workers' compensation medical, indemnity, and other related payments. Claims adjusting services are provided by a third-party administrative claims adjusting service. Interfund premiums on workers' compensation are determined by position class code, at actuarially determined rates.

The County has reinsurance coverage for excess workers' compensation and employer's liability. The retention (deductible) for the fiscal year ended February 28, 2006 is \$850,000 per occurrence. During the last three fiscal years, no claims incurred exceeded the insurance coverage for the County. Through the County, the District provides medical, dental, vision, and basic life and disability insurance to eligible employees and retirees. The District pays the full cost of health benefits for eligible employees and retirees and 50% of the cost of dependent premiums. Disability insurance will pay up to 50% of an employee's salary for two years with an employee option to extend the benefits period to age 65 and increase the percentage to 60%.

The District's group insurance premiums, as well as employee payroll deductions for premiums for dependents and optional coverages, are paid into the County's Health Insurance Trust Fund, which in turn makes disbursements to contracted insurance providers based upon monthly enrollment and premium calculations.

Billings to the District for property insurance, professional liability insurance, and crime and fidelity policies are handled through the County's Risk Management Fund, as are payments to the insurance carriers. Claim payments made up to the deductible limit are expensed by the District when paid by the Risk Management Fund. Payments for the District's general, vehicle, and property damage liability claims, for which the County is self-insured, are made through the Risk Management Fund and billed to the District.

11. RESTATEMENT

During fiscal year 2006, the beginning net assets for the government-wide statements was restated by \$125,739,216 for the effects of a previous overstatement of bond premium net of amortization and the addition of prior year construction in progress additions that were not previously reported. The construction in progress additions relate to flood control projects in which the District is participating with the Army Corps of Engineers. In addition, a new agency fund was established to reflect an escrow deposit made by the District in connection with an Army Corps of Engineers joint project.

**HARRIS COUNTY FLOOD CONTROL DISTRICT
A COMPONENT UNIT OF HARRIS COUNTY, TEXAS
NOTES TO THE FINANCIAL STATEMENTS
February 28, 2006**

	Governmental Net Assets
Net Assets as previously reported	\$ 1,354,928,052
Overstatement of bond premium, net of amortization	660,353
Additional capital asset values	125,078,863
Restated Net Assets as of March 1, 2005	\$ 1,480,667,268

In addition to the changes to beginning fund balance and net assets as discussed above, the following amounts were restated to reflect activity for fiscal year 2006 related to the items discussed above:

	As Previously Reported	As Restated
<u>Statement of Net Assets</u>		
Land and construction in progress	\$ 1,481,957,807	\$ 1,527,346,161
Other capital assets, net of depreciation	190,440,888	268,841,654
Total assets	1,910,037,426	2,033,826,546
Invested in capital assets, net of related debt	1,307,736,573	1,431,525,678
Unrestricted	67,189,437	67,189,452
Total net assets	1,397,555,359	1,521,344,479

	As Previously Reported	As Restated
<u>Statement of Activities</u>		
Expenses - Flood control administration	\$ 71,800,323	\$ 84,205,058
Program Revenues - Operating grants and contributions	37,812,070	22,734,308
Program Revenues - Capital grants and contributions	21,117,019	47,309,773
Net (Expenses) Revenue and Changes in Net		
Assets - Flood control administration	(11,863,340)	(13,153,083)
Net (Expenses) Revenue and Changes in Net Assets	(31,739,031)	(33,028,774)
Changes in net assets	41,966,954	40,677,211
Net assets -ending	1,397,555,359	1,521,344,479

	Operations and Maintenance (General) fund column		Capital Projects fund column		Total 2006 column	
	As Previously		As Previously		As Previously	
	Reported	As Restated	Reported	As Restated	Reported	As Restated
<u>Statement of Revenues, Expenditures and</u>						
<u>Changes in Fund Balance - Governmental Funds</u>						
Expenditures:						
Flood control administration	\$ 50,928,577	\$ 51,687,419	\$ 104,734	\$ 6,945,223	\$ 51,161,802	\$ 58,761,133
Capital outlay	4,062,532	3,303,690	69,748,625	62,908,136	75,589,718	67,990,387

**HARRIS COUNTY FLOOD CONTROL DISTRICT
A COMPONENT UNIT OF HARRIS COUNTY, TEXAS
NOTES TO THE FINANCIAL STATEMENTS
February 28, 2006**

	As Previously Reported	As Restated
<u>Statement of Fiduciary Net Assets - Agency Funds</u>		
Cash and cash equivalents	\$ -	\$ 1,537,640
Total assets	-	1,537,640
Held for others	-	1,537,640
Total liabilities	-	1,537,640

In addition to the restatement items noted above, there have been additional subsequent events. The following are additional bond issuances:

On December 13, 2006, the Flood Control District issued and settled \$94,185,000 Flood Control District Contract Tax Refunding Bonds, Series 2006A to defease all or a portion of the County's outstanding Flood Control District's Contract Tax Commercial Paper Notes, Series F and to pay cost of issuance and refunding. The annual interest rate is at 5%. The issuance had a premium of \$6,185,667. Interest accrues semiannually and the bonds mature in fiscal year 2031. There was no economic gain or loss due to the refunding of commercial paper.

On January 18, 2007, the Flood Control District issued and settled \$89,600,000 Flood Control District Improvement Bonds, Series 2007 to finance certain flood control improvements and to pay cost of issuance. The annual interest rates range from 4.75%-5.0%. The issuance had a premium of \$5,398,016. Interest accrues semiannually and the bonds mature in fiscal year 2031.

12. RECENT ACCOUNTING PRONOUNCEMENTS

GASB Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other than Pension Plans* ("GASB 43"), establishes uniform financial reporting standards for OPEB plans and supersedes the interim guidance included in GASB Statement No. 26, *Financial Reporting for Postemployment Healthcare Plans Administered by Defined Benefit Pension Plans*. The District will implement GASB 43 in fiscal year 2007.

GASB Statement No. 44, *Economic Condition Reporting: The Statistical Section – an Amendment of NCGA Statement 1* ("GASB 44"), updates the statistical section requirements to include guidance for all types of state and local governments, improve the understandability, comparability, and usefulness in the statistical section of the CAFR, and assist users in assessing the state or local government's economic condition. GASB 44 will be implemented by the District in fiscal year 2007.

GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions* ("GASB 45"), establishes standards for the measurement, recognition, and display of OPEB expense/expenditures and related liabilities (assets), note disclosures, and if applicable, required supplementary information (RSI) in the financial reports of state and local governmental employers. The District will implement GASB 45 in fiscal year 2008.

GASB Statement No. 46, *Net Assets Restricted by Enabling Legislation – an amendment of GASB 34* ("GASB 46"), clarifies that a legally enforceable enabling legislation restriction is one that a party external to a government – such as citizens, public interest groups, or the judiciary – can compel a government to honor. GASB 46 states that the legal enforceability of an enabling legislation restriction should be reevaluated if any of the resources raised by the enabling legislation are used for a purpose not specified by the enabling

**HARRIS COUNTY FLOOD CONTROL DISTRICT
A COMPONENT UNIT OF HARRIS COUNTY, TEXAS
NOTES TO THE FINANCIAL STATEMENTS
February 28, 2006**

legislation or if a government has other cause for reconsideration. This statement also specifies the accounting and financial reporting requirements if new enabling legislation replaces existing legislation or if legal enforceability is reevaluated. Finally, GASB 46 requires governments to disclose the portion of total net assets that is restricted by enabling legislation. The District will implement this statement in fiscal year 2007.

GASB Statement No. 47, *Accounting for Termination Benefits* ("GASB 47"), establishes accounting standards for termination benefits (voluntary and involuntary). GASB 47 will be implemented by the District in fiscal year 2007.

REQUIRED SUPPLEMENTARY INFORMATION

**HARRIS COUNTY FLOOD CONTROL DISTRICT
A COMPONENT UNIT OF HARRIS COUNTY, TEXAS
REQUIRED SUPPLEMENTARY INFORMATION
SCHEDULE OF REVENUES AND EXPENDITURES
BUDGET AND ACTUAL - BUDGETARY BASIS
OPERATIONS AND MAINTENANCE (GENERAL) FUND
For The Year Ended February 28, 2006**

	OPERATIONS AND MAINTENANCE (GENERAL) FUND			Variance with Final Budget Positive (Negative)
	Original Budget	Final Budget	Actual	
REVENUES AND OTHER FINANCING SOURCES				
Beginning Cash and Investments:				
Flood Control General	\$ 74,020,665	\$ 74,020,665	\$ 76,324,169	\$ 2,303,504
FC Ser F Comm Paper	1,674,441	1,674,441	1,676,388	1,947
Total Beginning Cash and Investments	<u>75,695,106</u>	<u>75,695,106</u>	<u>78,000,557</u>	<u>2,305,451</u>
Interest:				
Flood Control General	1,863,432	1,863,432	1,703,011	(160,421)
FC Ser F Comm Paper	33,619	33,619	24,234	(9,385)
FC Refunding Series 2003 B Debt Service Fund	-	170	1,752	1,582
FC Refunding Series 2004 A Debt Service Fund	-	29	3,636	3,607
Total Interest	<u>1,897,051</u>	<u>1,897,250</u>	<u>1,732,633</u>	<u>(164,617)</u>
Taxes:				
Flood Control General	49,054,295	49,054,295	53,032,416	3,978,121
Miscellaneous:				
Flood Control General	281,800	281,800	215,491	(66,309)
Other - Sale of Real Property:				
Flood Control General	-	-	691,572	691,572
Other Transfers In:				
FC Ser F Comm Paper	440,000	440,000	-	(440,000)
FC Refunding Series 2003 B Debt Service Fund	-	9,784,600	9,780,000	(4,600)
FC Refunding Series 2004 A Debt Service Fund	-	11,362,376	12,893,482	1,531,106
Total Other Transfers In	<u>440,000</u>	<u>21,586,976</u>	<u>22,673,482</u>	<u>1,086,506</u>
Total Revenue and Other Financing Sources	<u>127,368,252</u>	<u>148,515,427</u>	<u>156,346,151</u>	<u>7,830,724</u>
EXPENDITURES AND OTHER FINANCING USES				
Flood Control General	125,220,192	125,220,192	55,267,258	69,952,934
FC Ser F Comm Paper	2,148,060	2,148,060	1,390,414	757,646
FC Refunding Series 2003B	-	9,791,844	9,784,600	7,244
FC Contract Tax 2004A	-	11,370,095	11,362,376	7,719
Total Expenditures and Other Financing Uses	<u>127,368,252</u>	<u>148,530,191</u>	<u>77,804,648</u>	<u>70,725,543</u>
Net changes in Fund Balance	<u>\$ -</u>	<u>\$ (14,764)</u>	<u>\$ 78,541,503</u>	<u>\$ 78,556,267</u>

See notes to required supplementary information.

**HARRIS COUNTY FLOOD CONTROL DISTRICT
A COMPONENT UNIT OF HARRIS COUNTY, TEXAS
NOTES TO THE REQUIRED SUPPLEMENTARY INFORMATION
February 28, 2006**

RECONCILIATION OF ACCOUNTING BASIS

A reconciliation of revenues and expenditures on a cash basis (budgetary basis) compared to modified accrual basis (GAAP) for the general fund is as follows:

	General Fund
REVENUES AND OTHER FINANCING SOURCES	
Cash (budgetary) basis	\$ 156,346,151
Accrued in 2005, received in 2006	207,943,337
Accrued in 2006, to be received in 2007	<u>(284,094,805)</u>
Revenues on modified accrual (GAAP) basis	<u>80,194,683</u>
EXPENDITURES AND OTHER FINANCING USES	
Cash (budgetary) basis	77,804,648
Incurred during 2005, paid in 2006	52,515,330
Incurred during 2006, payable in 2007	<u>(52,350,681)</u>
Expenditures on modified accrual (GAAP) basis	<u>77,969,297</u>
Net changes in Fund Balance	<u><u>\$ 2,225,386</u></u>

For further budgeting information, see Note 1.D. of the Notes to the Financial Statement.

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INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133 (AS REVISED)

County Judge Ed Emmett and
Members of Commissioners Court of
Harris County, Texas:

Compliance

We have audited the compliance of Harris County Flood Control District (the "District") with the types of compliance requirements described in the *U.S. Office of Management and Budget ("OMB") Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended February 28, 2006. The District's major federal programs are identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts and grant agreements applicable to each of its major federal programs is the responsibility of the District's management. Our responsibility is to express an opinion on the District's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the District's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the District's compliance with those requirements.

In our opinion, the District complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended February 28, 2006. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements that are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying Schedule of Findings and Questioned Costs as finding 06-01.

As discussed in Note 3 to the Schedule of Expenditures of Federal Awards, the Schedule of Findings and Questioned Costs was revised for the inclusion of material weaknesses related to the financial statements.

Internal Control Over Compliance

The management of the District is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the District's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the District's internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grant agreements caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the District's internal control over compliance and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the County Judge and Commissioners Court members, management, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Deloitte & Touche LLP

July 27, 2006 (September 25, 2007 as to Note 3 to the Schedule of Expenditures of Federal Awards)

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND COMPLIANCE AND OTHER MATTERS BASED UPON THE AUDIT PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS (AS REVISED)

County Judge Ed Emmett and
Members of Commissioners Court of
Harris County, Texas:

We have audited the basic financial statements of Harris County Flood Control District (the "District"), as of and for the year ended February 28, 2006, and have issued our report thereon dated July 27, 2006 (September 25, 2007 as to the effects of the restatement discussed in Note 11 to the Financial Statements and Note 3 to the Schedule of Expenditures of Federal Awards). We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the District's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the District's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying schedule of findings and questioned costs as items 06-02 and 06-03.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. We believe that the reportable conditions described above are material weaknesses.

Compliance and Other Matters

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

This report is intended solely for the information and use of the County Judge and Commissioners Court members, management, federal and state awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Deloitte & Touche LLP

July 27, 2006 (September 25, 2007 as to the effects of the restatement discussed in Note 11 to the Financial Statements and Note 3 to the Schedule of Expenditures of Federal Awards)

HARRIS COUNTY FLOOD CONTROL DISTRICT, TEXAS
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED FEBRUARY 28, 2006

Fund No.	Federal Grantor / Pass-Through Agency Grantor / Program	CFDA Number	Grantor or Pass-through Grantor's Number	Federal Expenditures	Amount Provided to Subrecipients
<u>FEDERAL GRANTS</u>					
<u>U.S. DEPARTMENT OF COMMERCE</u>					
PASS THROUGH PROGRAMS, GENERAL LAND OFFICE:					
7418	Coastal Management Plan	11.419	GLO-04-015	\$ 41,309	\$ -
TOTAL U.S. DEPARTMENT OF COMMERCE				<u>41,309</u>	<u>-</u>
<u>U.S. DEPARTMENT OF HOMELAND SECURITY</u>					
PASS THROUGH PROGRAMS, GOVERNORS DIVISION OF EMERGENCY MANAGEMENT:					
7004/7031	FEMA - Pre-Disaster Mitigation Competitive	97.017	EMT-2004-PC-0003-03-009	227,036	-
7004/7031	FEMA - Pre-Disaster Mitigation Competitive	97.017	EMT-2004-PC-0003-03-007	572,431	-
7004/7031	FEMA - Pre-Disaster Mitigation Competitive	97.017	EMT-2004-PC-0003-03-012	459,986	-
7288/7293	FEMA - Hazard Mitigation Grant Project	97.039	FEMA-1439-DR-TX-05	324,022	-
TOTAL U.S. DEPARTMENT OF HOMELAND SECURITY				<u>1,583,475</u>	<u>-</u>
<u>U.S. DEPARTMENT OF DEFENSE</u>					
PASS THROUGH PROGRAMS, ARMY CORPS OF ENGINEERS:					
3310	Brays Bayou Federal Project	12.000	NONE	9,475,367	-
TOTAL U.S. DEPARTMENT OF DEFENSE				<u>9,475,367</u>	<u>-</u>
TOTAL EXPENDITURES OF FEDERAL AWARDS				<u>\$ 11,100,151</u>	<u>\$ -</u>

See notes to schedule of expenditures of federal awards.

**HARRIS COUNTY FLOOD CONTROL DISTRICT
A COMPONENT UNIT OF HARRIS COUNTY, TEXAS**

**NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED FEBRUARY 28, 2006 (Revised)**

- The accompanying schedule of expenditures of federal awards includes the federal grant activity and state grant activity of the District and is presented on the cash basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

Federal awards provided to subrecipients are treated as an expenditure when paid to the subrecipient.

- Reconciliation of the Schedule of Expenditures of Federal Awards to Grants Special Revenue Fund of the District's Financial Report for the year ended February 28, 2006:

Federal expenditures per schedule	\$	11,100,151
Add:		
Trial Balance adjustments for modified accrual basis of accounting		(123,404)
County funded portion of grants		405,675
Less:		
Grants - Other fund types		<u>(9,475,370)</u>
Total	\$	<u><u>1,907,052</u></u>
Balance per financial report - Grants Special Revenue Fund	\$	<u><u>1,907,052</u></u>

- Subsequent Event – Parts I and II of the Schedule of Findings and Questioned Costs for the year ended February 28, 2006 has been revised to disclose material weaknesses 06-02 and 06-03. The dollar threshold for Type A programs was changed to \$333,004.

**HARRIS COUNTY FLOOD CONTROL DISTRICT
A COMPONENT UNIT OF HARRIS COUNTY, TEXAS**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED FEBRUARY 28, 2006 (Revised)**

I. SUMMARY OF AUDITORS' RESULTS

1. The independent auditors' report on the basic financial statements expressed an unqualified opinion.
2. Material weaknesses in internal control over financial reporting were identified.
3. No instance of noncompliance considered material to the basic financial statements was disclosed in the audit.
4. No material weaknesses in internal control over compliance with requirements applicable to major federal awards programs were identified.
5. The independent auditors' report on compliance with requirements applicable to major federal awards programs expressed an unqualified opinion.
6. The audit disclosed findings required to be reported by OMB Circular A-133.
7. The District's major programs were:

Name of Major Federal Program	CFDA Number
FEMA - Hazard Mitigation Grant	97.039
FEMA - Pre-Disaster Mitigation	97.017
Brays Bayou Contract	12.000

8. For federal awards, a dollar threshold of \$333,004 was used to distinguish between Type A and Type B programs, as defined in OMB Circular A-133 and UGMS.
9. The District qualified as a low-risk auditee, as defined in OMB Circular A-133.

**HARRIS COUNTY FLOOD CONTROL DISTRICT
A COMPONENT UNIT OF HARRIS COUNTY, TEXAS**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED FEBRUARY 28, 2006 (Revised)**

II. FINANCIAL STATEMENT FINDINGS SECTION

Program	Finding/Noncompliance	Questioned Cost
----------------	------------------------------	----------------------------

Finding 06-02 – Material Weakness

Condition: The County’s construction work in progress (CWIP) included items that did not qualify for capitalization. Some of these items have been included in CWIP for several years. Additionally, certain completed projects that should have been reclassified into other capital asset categories remained recorded in CWIP.

N/A

Criteria: The CWIP account should include those assets that will ultimately meet the County’s capitalization thresholds and policies for recording as capital assets. Those department personnel responsible for CWIP projects should identify such projects to the Capital Asset Section of the County Auditor’s Office; additionally, those department personnel should report when projects are completed so that they may be properly reclassified in the financial records. The Capital Asset Section should review appropriate documentation to conclude on the propriety of recording items into and removing items from the CWIP capital asset category.

Cause: Personnel in the County departments responsible for creation of projects eligible to be capitalized appear to not have a clear understanding of what types of expenditures should be capitalized or expensed as repairs and maintenance or other non-capital expenditures. During and subsequent to fiscal year 2007, the Capital Asset Section initiated a review of supporting documentation to verify whether projects included in CWIP were eligible to be capitalized. The most common error found related to projects for which the County will not own the completed project improvements.

Personnel in various County departments did not accurately report the status of projects in order to properly account for the CWIP transfers into fixed assets. The County has a policy in place that, when a project is 95% complete, the County department responsible for the project sends a Certificate of Substantial Completion to Commissioners Court for approval. After verifying that final payment has been approved by Commissioners Court, the Capital Asset Section reclassifies the project from CWIP to the permanent asset class (i.e.: roads, buildings, etc.) at the end of the fiscal year.

Effect: The County is not following its own policies regarding recording of CWIP. The County’s CWIP account, capital asset categories, and certain expenditures categories contained material errors which were identified and corrected by the Capital Assets Section.

**HARRIS COUNTY FLOOD CONTROL DISTRICT
A COMPONENT UNIT OF HARRIS COUNTY, TEXAS**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED FEBRUARY 28, 2006 (Revised)**

Program	Finding/Noncompliance	Questioned Cost
----------------	------------------------------	----------------------------

Recommendation: The County Auditor's Office should communicate to County departments the importance of the project set-up and project close-out procedures which require submission of executive summaries with the project set-up request and the letter of substantial completion when the project is 95% complete. Training should be provided to these departments and employees who will be involved in this process. The acceptance by the County's operating departments of these policies, procedures and training is imperative in order to make this process work.

Further, the County should have a specific section that is responsible for monitoring of CWIP projects, with support from the employees in other departments that are involved. This section would review the process as they receive information from each of the departments and would keep track of all projects. This would allow for a more timely identification and resolution of issues with CWIP projects.

Corrective Action Plan of Management: We agree with this recommendation. Financial Accounting implemented a procedure during fiscal year 2008 requiring new master project set-up requests to include an executive summary in order to be established on the financial accounting system. Capital project training is being developed by Systems and Procedures and Financial Accounting. The training will include the importance of project set-up and project close-out procedures. Also, fixed and capital asset training was offered at the employee training conference during fiscal year 2007. The Capital Asset section of Financial Accounting is responsible for the monitoring of CWIP projects including the timely identification and resolution of issues.

Estimated Completion Date: 02/29/2008

County Contact Persons: Carol Market, Director of Financial Accounting and Emily Lam-Jones, Manager of Capital Assets

Finding 06-03 – Material Weakness

Condition: The County's capital asset records did not include certain projects for which title belongs to the County or the Flood Control District. Some of these projects started in the 1980s and 1990s. A review of the agreement terms for these projects clearly indicates that these assets become County or Flood Control District property upon completion. Specific examples include flood control projects for Sims Bayou and Clear Creek, and the South Houston Library building. Additionally, the County identified parcels of land for which the County owned the title, but which had not been recorded as capital assets.

N/A

**HARRIS COUNTY FLOOD CONTROL DISTRICT
A COMPONENT UNIT OF HARRIS COUNTY, TEXAS**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED FEBRUARY 28, 2006 (Revised)**

Program	Finding/Noncompliance	Questioned Cost
	<p><u>Criteria:</u> The financial records of the County should reflect all transactions undertaken by the County. All significant agreements, to include reimbursement contracts, local cooperation agreements, grants, or any similar agreements, entered into by the County should be reviewed by personnel of the County Auditor's Office to assess the financial reporting implications of these agreements.</p> <p><u>Cause:</u> Due to the decentralized nature of County operations, agreements are negotiated by County departments and may contain provisions with financial reporting implications that the County Auditor's Office personnel are not aware of. No clear policies and procedures exist at the County department level to ensure that the County Auditor's Office is informed of contracts with financial reporting implications. Although existing policies within the County Auditor's Office for review of contracts did not identify these items in the normal course of business, the Capital Asset Section initiated a review of payments to various entities for construction projects to identify unrecorded assets.</p> <p><u>Effect:</u> The County's capital asset accounts contained material errors which were discovered and corrected by the Capital Assets Section.</p> <p><u>Recommendation:</u> The County Auditor's Office should assess its existing policies for review of contracts and other agreements. Consider preparing detailed instructions for personnel who will perform such reviews, as well as training on the policies and the purpose of the review. Management personnel should review the work of the initial contract reviews to assure that the appropriate conclusions were reached regarding what financial accounting entries should be made to reflect the transactions identified.</p> <p>Consider options for requiring County departments to communicate to the County Auditor's Office when contracts which relate to capital assets are negotiated. The County should also consider performing a complete inventory of its capital assets, which might include retaining an outside vendor to assist in searching a variety of records for assets to which the County has title.</p> <p><u>Corrective Action Plan of Management:</u> We agree with this recommendation. The Capital Asset Section is currently developing a systematic approach for the review of contracts so that transactions are recorded timely and accurately on the financial records of the County. Financial Accounting will work with the Public Infrastructure Department and other County departments to develop a method of identifying non-standard contracts that have an impact on capital assets. The County Auditor's Office is in agreement that the County should consider performing a complete inventory of its capital assets, which might include retaining an outside vendor. The Auditor's Office will communicate this</p>	

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Program	Finding/Noncompliance	Questioned Cost
	<p>recommendation to the Public Infrastructure Department and other applicable departments.</p> <p><u>Estimated Completion Date:</u> 02/29/2008</p> <p><u>County Contact Persons:</u> Carol Market, Director of Financial Accounting and Emily Lam-Jones, Manager of Capital Assets</p>	

III. FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS SECTION

Program	Finding/Noncompliance	Questioned Cost
	Finding 06-01	
Coastal Management Plan, CFDA: 11.419;	<u>Condition:</u> The Purchasing Agent’s policies and procedures do not require verification that contractors hired to provide goods and services for Federal grant programs are excluded from the Federal list of suspended or debarred vendors.	None
FEMA – Pre-Disaster Mitigation, CFDA: 97.017;	<u>Criteria:</u> Executive Order #12549 (via the Common Rule) requires that grantees “Not allow a party to participate in any affected program if any Executive department or agency has debarred, suspended, or otherwise excluded (to the extent specified in the exclusion agreement) that party from participation in an affected program.” The Executive Order also specifies that the federal government will maintain a list of suspended and debarred parties.	
FEMA – Hazard Mitigation Grant, CFDA: 97.039;	<u>Effect:</u> As contractors are not compared to suspended or debarred vendor list, it is possible that the County may be doing business with federally excluded vendors.	
Brays Bayou Contract, CFDA: 12.000	<u>Cause:</u> The County has not implemented proactive procedures to identify whether potential vendors are suspended or debarred prior to contracting with them.	
	<u>Recommendation:</u> Implement procurement procedures to include the comparison of potential vendors against the suspended or debarred vendor list. Provide training to purchasing personnel (and other personnel to which this responsibility may be assigned) on the revised procurement procedures in order to ensure compliance with Federal laws and regulations.	
	<u>Corrective Action Plan of Management:</u> The Purchasing Agent will	

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Program	Finding/Noncompliance	Questioned Cost
	<p>develop policies and procedures to verify the County is not doing business with federally excluded vendors. The Purchasing Agent will also provide the necessary training to personnel responsible for ensuring the policies and procedures are followed.</p> <p><u>Estimated Completion Date:</u> 02/28/2007</p> <p><u>County Contact Persons:</u> Jack R. McCown, Purchasing Agent</p>	

IV. STATUS OF PRIOR YEAR FINDINGS AND QUESTIONED COSTS

Program	Finding/Noncompliance	Questioned Cost
	Finding 05-01	
Coastal Management Plan, CFDA: 11.419;	<u>Finding:</u> The Purchasing Agent’s policies and procedures do not require verification that contractors hired to provide goods and services for Federal grant programs are excluded from the Federal list of suspended or debarred vendors.	None
FEMA – Pre-Disaster Mitigation, CFDA: 97.017;	<u>Recommendation:</u> Implement procurement procedures to include the comparison of potential vendors against the suspended or debarred vendor list. Provide training to purchasing personnel (and other personnel to which this responsibility may be assigned) on the revised procurement procedures in order to ensure compliance with Federal laws and regulations.	
FEMA – Hazard Mitigation Grant, CFDA: 97.039;		
Brays Bayou Contract, CFDA: 12.000	<u>Status:</u> The Purchasing Agent had a clause added to all contracts that requires vendors to certify to the County any eligibility violation with Executive Order 12549, “Debarment and Suspension”, regarding federal or state assistance programs.	