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**HARRIS COUNTY AUDITOR**

July 22, 2004

Honorable District Judges of Harris County and  
Honorable Members of the Harris County Commissioners Court

The County Auditor's Office (the "Auditor's Office") is pleased to present the Comprehensive Annual Financial Report ("CAFR") of Harris County, Texas (the "County") for the fiscal year ended February 29, 2004. This report is submitted in accordance with Section 114.025 of the Texas Local Government Code and was prepared by the staff of the County Auditor's Office

The report consists of management's representations concerning the finances of the County. Therefore, management assumes full responsibility for the completeness and reliability of all of the information presented in this report. We believe the information and data contained herein are accurate in all material respects; that it is reported in a manner designed to present fairly the financial position and results of operations of the County in accordance with generally accepted accounting principles in the United States of America ("GAAP"). All disclosures necessary to enable the reader to gain an understanding of the County's financial activities have been included.

Management of the County has established a comprehensive internal control framework that is designed both to protect the government's assets from loss, theft, or misuse, and to compile sufficient reliable information for the preparation of the County's financial statements in conformity with GAAP. Because the cost of internal controls should not outweigh their benefits, the County's comprehensive framework of internal controls has been designed to provide reasonable rather than absolute assurance that the financial statements are free from material misstatement.

The County's financial statements were audited by Deloitte & Touche LLP, a firm of licensed certified public accountants. The goal of the independent audit was to provide reasonable assurance that the financial statements of the County for fiscal year ended February 29, 2004 are free of material misstatement. The independent auditor concluded, based upon the audit, that there was a reasonable basis for rendering an unqualified opinion that the County's financial statements are fairly presented in conformity with GAAP. The independent auditor's report is presented as the first component of the financial section of this report.

The independent audit of the County's financial statements was part of a broader, federally mandated "Single Audit" designed to meet the special needs of federal and state grantor agencies. The standards governing Single Audit engagements require the independent auditor to report not only on the fair presentation of the financial statements, but also on the government's internal controls and compliance

with legal requirements, with special emphasis on internal controls and legal requirements involving the administration of federal and state awards. These reports are available in the compliance section of this report.

This is the second year that the CAFR was prepared in conformity with the new financial reporting requirements established by Governmental Accounting Standards Board (GASB) No. 34, "Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments." The County is required by GASB 34 to provide a narrative introduction, overview, and analysis to accompany the basic financial statements. The narrative is referred to as "Management's Discussion and Analysis: (MD&A) and the current year's CAFR presents the first period for which comparative financial information is displayed in the MD&A. The CAFR is presented in four sections as illustrated in the following:

- ◆ The ***Introductory Section***, which is unaudited, contains the letter of transmittal (this letter), an organization chart of the County and a list of elected and selected appointed officials, and a reproduction of the County's Certificate of Achievement for Excellence in Financial Reporting for the year preceding this report.
- ◆ The ***Financial Section*** includes the Independent Auditor's Report, Management Discussion and Analysis ("MD&A"), the Basic Financial Statements (including notes) and required Supplementary Information. The MD&A is designed to complement the letter of transmittal and should be read in conjunction with it and can be found immediately following the report of the independent auditors. The Basic Financial Statements include the government-wide financial statements that are designed to provide an overview of the County's entire financial operations. In addition, the fund financial statements present financial information of each of the County's major funds, as well as non-major funds, fiduciary funds, and other funds.
- ◆ The ***Statistical Section*** includes selected financial, demographic, and statistical data that is generally presented on a multiyear basis, and other information which includes supplemental disclosures to comply with Securities Exchange Commission Rule 15c2-12.
- ◆ The ***Compliance Section*** contains information related to the County's annual single audit, which is required under the provisions of the Single Audit Act of 1984, the Single Audit Act Amendments of 1996, and the U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Included are a Supplementary Schedule of Federal and State Awards, Notes to Supplementary Schedule of Expenditures of Federal and State Awards, the Independent Auditor's Report on Compliance and Internal Control Over Financial Reporting Based on an Audit of Basic Financial Statements Performed in Accordance With Government Auditing Standards, the Independent Auditor's Report on Compliance with Requirements Applicable to Each Major Program and on Internal Control Over Compliance in Accordance With OMB Circular A-133, and a Schedule of Findings and Questioned Costs.

## PROFILE OF THE COUNTY

### ***History, Geographic Location, and Population***

The first written record of the area that is now Harris County was made in 1528 by Alvar Nunez Cabeza De Vaca, a member of a Spanish expedition. In 1821, Stephen F. Austin began a survey of land for a settlement of 300 families. Two years later, John Richardson Harris erected a trading post between Buffalo and Brays Bayous, and within three more years he laid out the town of Harrisburg.

The approval of Harrisburg was one of the first acts of the new congress in 1837, Texas itself having come into being in 1836. In 1839, it was renamed Harris County.

The County is located in the Gulf Coast region of Texas approximately 50 miles from the Gulf of Mexico and covers over 1,700 square miles with approximately 3.4 million residents. The County ranks as one of the top ten fastest growing counties in the nation as well as third most populous county in the nation.

### ***County Structure and Services***

Harris County is a political subdivision of the State of Texas and the Commissioners Court is the governing body of the County. It is composed of the County Judge elected from the County at large, and four Commissioners, each elected from a separate precinct, all elected for four year terms. The County Judge is the presiding office of the Commissioners Court.

The County (the primary government), and its component units solely or in cooperation with other local governmental entities provide a full range of services allowed by the Texas Constitution and Statutes that include, construction and maintenance of roads and bridges, health and housing services, social services, judicial and law enforcement, juvenile and adult justice programs, economic development, library system, parks, recreation and cultural enrichment, flood control, a sports and entertainment complex, and general administration.

### ***Component Units***

The combined financial statements of the County as a financial reporting entity report all activities, organizations, and functions of the County, both as the primary government and its legally separate component units for which (1) the elected officials of the County are financially accountable and/or (2) exclusion of component units activities would cause the County's financial statements to be misleading or incomplete. The County's component units have been reported as blended with the County as the primary government or as discrete (separate) component unit, as appropriate. Criteria used by the County for including activities in preparing these financial statements are in conformity with the GASB14, The Financial Reporting Entity and GASB 39, *Determining Whether Certain Organizations are Component Units*. Based on the requirements of these accounting standards, the County is financially accountable for the following component units:

- Harris County Flood Control District
- Harris County Industrial Development Corporation
- Harris County Hospital District
- Harris County Juvenile Board
- Harris County Housing Finance Corporation
- Mental Health and Mental Retardation Authority of Harris County
- Harris County Sports and Convention Corporation
- Children's Assessment Center Foundation, Incorporated
- Housing Authority of Harris County
- Harris County Health Facilities Development Corporation
- Harris County Cultural Education Facilities Finance Corporation

### ***Budget Process***

In accordance with Chapter 111 of the Local Government Code, the County prepares and adopts an annual operating budget which serves as a financial plan for the new fiscal year beginning March 1. After adoption of the budget by Commissioners Court, the County Auditor is responsible for ensuring

expenditures are made in compliance with budgeted appropriations. The level of budgetary control is the department within an individual fund. Commissioners Court may transfer available funds between various departments. However, no transfer may increase the total appropriation of a fund. Commissioners Court may also adopt supplemental budgets for the limited purposes of spending grant or aid money or for capital projects through the issuance of bonds. Purchase orders and contracts are not valid until the County Auditor certifies availability of funds for payment of the obligation. Encumbrance accounting is utilized to ensure effective budgetary control and accountability, and unencumbered appropriations lapse at year-end.

## INFORMATION USEFUL IN ASSESSING ECONOMIC CONDITION

### *Local Economy*

The County currently enjoys a favorable economic environment. This is primarily attributable to expansion and diversification away from the oil and gas industry subsequent to a recovery from a major recession in 1982 and growth in high technology industries, medical research, health care and professional services. The County's traditional dependence on the energy sector is projected to continue to decrease since economic expansion is also fueled by the County's proximity to the Gulf of Mexico, as well as by the important role the area plays as a major manufacturing, shipping, and tourism center. Substantial structural alteration of the County's economy over the past 22 years has reduced its vulnerability to downturns in upstream energy, which nonetheless continues to influence the County far more than it does the nation as a whole. However, the primary factors that will influence the County's economic future are: the health of the national economy, energy prices, and the value of the dollar against major foreign countries.

Today, Harris County's economy is largely based on a broad spectrum of industries including:

- Oil and gas exploration
- Basic petroleum refining
- Petrochemical production
- Medical research and health care delivery
- High technology – computers, aerospace, environmental, etc.
- Government – city, county, state and federal (i.e. NASA)
- International import & export
- Commercial fishing
- Agriculture
- Education
- Banking and finance
- Manufacturing and distribution
- Related service industries

The County is also home to many businesses including corporate headquarters for 19 of the Fortune 500 companies. Houston, the largest city in the County ranks fifth among metro areas (MSAs and CMSAs) in the number of Fortune 500 headquarters, behind New York, Chicago, San Francisco, and Los Angeles. Many other Fortune 500 companies maintain U.S. administrative offices in Houston.

Among U.S. ports, the Port of Houston is ranked first in the U.S. in foreign waterborne commerce, second in total tonnage, and sixth in the world overall. The Port of Houston continued to serve as the main driver of global trade and commerce in fiscal year 2004.

The Houston Ship Channel is a 52-mile inland waterway which connects Houston to the Bay of Galveston, the Gulf Intra-coastal Waterway, the Gulf of Mexico, and ultimately the major shipping lanes of the world. It has been a catalyst for growth in Harris County since the first journey of a steamship up Buffalo Bayou in 1837. The ship channel plays a critical role in today's community as

well in generating jobs and opportunities that allow businesses to flourish. Economic studies reveal that ship channel-related businesses support more than 287,000 direct and indirect jobs throughout Texas while generating nearly \$11 billion in economic impact. Additionally, more than \$649 million in state and local tax revenues are generated by business activities related to the port.

In addition to the County's moderate climate and diverse economic base, it offers a modern and efficient infrastructure for people working and doing business in the County. This includes a local government that encourages business development, high capacity freeways, major rail lines, three major airports (George Bush Intercontinental, Houston Hobby, and Ellington Field) and telecommunication services that are state of the art.

For the 12 months ending July 2003, Houston sustained a net loss of 9,300 jobs or 0.4 percent while the nation as a whole lost 404,000 jobs. Among the 10 most populous areas, Houston ranked 4<sup>th</sup> in nominal employment growth and 5<sup>th</sup> in employment growth rate.

Harris County is the nation's third most populous county, ranking behind Los Angeles County and Cook County. The County's population base includes a wide variety of racial and ethnic groups that give a rich diversity and cosmopolitan feel. During 2003 – 2030, the Perryman Group sees population growth averaging 1.71 percent annually in the Houston region. Over the same period, the prominent Texas based economic forecasting firm expects employment to rise at a 1.81 percent annual rate.

Bargain housing prices and a low tax burden keep living expenses in the County below those of most major metropolitan areas. The ACCRA Cost of Living Index (second quarter of 2003) shows that Houston's overall after-taxes living costs are 9 percent below the nationwide average, largely due to housing costs that are 21 percent below the average.

There are 23 public school districts entirely or partially within Harris County. Some school districts offer "magnet" school programs, whereby students can attend a special school where the electives focus on career-related courses. In addition, approximately 51,000 students attend 195 accredited private and parochial schools. The area's private schools are concentrated in Harris County, which has 172 private schools and approximately 40,000 students in these school systems. The County is also home to over 47 colleges, universities, institutes, and technical schools. Major institutions include Rice University, University of Houston, Texas Southern University, Houston Baptist University, the University of Texas Medical School and Baylor College of Medicine.

The County's major hospitals consistently rank among the nation's top institutions. Many of these facilities are concentrated in the Texas Medical Center, a non-profit organization devoted to health education, research and patient care. Located just south of downtown Houston, the Texas Medical Center offers world-class facilities for general and specialized medical needs.

Cultural attractions within Houston include a thriving theater district and numerous museums. Houston's theater district includes the Wortham Center (ballet and opera), Jones Hall (symphony), The Alley (live theater) and the Hobby Center (Broadway productions, etc.). All of these companies have mounted productions that are considered world class by experts in the field.

Houston is home to numerous professional and collegiate sports teams. Professional teams include: Astros, Major League Baseball; Texans, National Football League; Rockets, National Basketball Association; Comets, Women's National Basketball Association; and the Aeros, American Hockey League. Houston hosted Super Bowl XXXVIII on February 1, 2004 and the Major League Baseball All-Star Game in July 2004.

#### ***Financial Policies and Long-Term Financial Planning***

The County continued to enjoy a favorable financial environment during the fiscal year. The

population growth of the unincorporated areas is considered by the Commissioners Court in assessing the appropriate service delivery within available resources in a cost-effective manner. Some of the examples of the County's financial policies are:

- Encouraged the use of five-year planning tool for revenue and expenditure projections;
- Expenditures are controlled to not exceed revenues;
- The policy of Commissioners Court is that balance financial operations will be maintained;
- Departments and managers are encouraged to build savings within their budget for future use;
- The minimum fund balance for the general fund and other operating funds should be no less than 15% of fiscal year expenditures;
- Full disclosure and open lines of communications are maintained with rating agencies. A continuing goal is to upgrade the County's debt rating. The bond rating services of Moody's Investors Service, Inc., Standard & Poor's Ratings Services, and Fitch IBCA, Inc. have assigned the County long term bond ratings of Aa1, AA+, and AA+.
- Use of the commercial paper program to take advantage of short-term interest rates during the interim financing period for voter authorized and other court approved projects rather than initially issuing long-term bonds.
- The County's investment policy primary objective is protection of principal and to provide for an effective cash management program to include accurate cash projections, expeditious collection of revenue, control of disbursements, cost-effective banking relations and a short term borrowing program, when needed. The "prudent person" concept is utilized in managing the portfolio for the County. To ensure safety of public funds, the policy adheres to Chapter 2256, Texas Government Code, The Public Funds Investment Act, and the statutory requirements of Local Government Code 116.112.

The County is responsible for setting the tax rates for the County, the Flood Control District, the Hospital District, and Port of Houston Authority (debt service only). Tax rates are levied for maintenance and operations and debt service requirements relative to General Obligation Bonds, Certificates of Obligation, Revenue Bonds and Commercial Paper. The respective tax rates which were adopted in 2003 by the County per \$100 of taxable value are: \$.34490 and \$.04313 for a total of \$.38803.

The investible funds under the County's investment program as of February 29, 2004 were \$1.66 billion and total investment earnings on that portfolio were \$25.1 million. The average yield and maturity of such investments were 1.625% and 173 days.

The Risk Management Department is responsible for assessing the County's exposure to risk and obtaining coverage against that risk. The County is self-insured for workers' compensation medical and indemnity payments and self-funded for dental and vision coverage provided under the employees' health insurance program. Although the County is now self insured for group medical benefits, traditional group medical insurance was purchased by the County during fiscal year 2004.

Additional information regarding the County's risk management program can be found in Note 15 of the notes to the financial statements.

The County provides retirement, disability, and death benefits for all of its full-time employees through a nontraditional defined benefit pension plan in the statewide Texas County and District Retirement

System (TCDRS). The County has elected the annually determined contribution rate (ADCR) plan provisions of the TCERS Act. The plan is funded by monthly contributions from both employee members and the employer based on the covered payroll of employee members. Under the TCERS ACT, the County's contribution rate is actuarially determined annually. The contribution rate payable by the employee members for fiscal year 2004 was 7%. In addition to providing retirement benefits, the County provides certain healthcare and life insurance benefits for retired employees. Additional information regarding the County's pension plan and post employment benefits can be found in Notes 13 and 14 of the notes to the financial statements.

***Major Initiatives***

Flood Control - The district's plans for improvements over the next five years of FY 2005 through FY 2009 total \$957.5 million. Federal reimbursements, watershed impact fees, and wetland mitigation funds would cover \$130.5 million or 13.6 % of the cost, and county funds would be required for \$827 million, or 86.4% of the five-year total. The District has requested the Commissioners Court for direction for two proposed programs that would be scheduled in the district's capital program beginning in FY 2006-07. Both programs are in response to requests for assistance from local governments. One would require \$10 million per year for offsite drainage needs in connection with road and bridge projects. Another would require an equal annual amount to assist local governments with flood damage reduction projects.

Toll Road - The Toll Road Authority has planned expenditures over the next five years of \$1,042,233,000. Current projects are completion of the Westpark Tollway, the Fort Bend Toll Road Connector, and Sam Houston Tollway lane widening from US 59S to IH 45N, and constructing Beltway 8 East and extension of Hardy. The Commissioners Court will continue to analyze the value and future direction of the authority.

Roads and Bridges - Expenditures in the amount of \$730.6 million for the next five years related to various road and bridge projects are planned. Joint funding from Metro, City of Houston, Toll Road for connectivity projects, and the Texas Department of Transportation is expected.

County Buildings - Various County facility projects are underway or are being considered. Some of the projects and related costs include the following:

• Civil Justice Center	\$121,534,000
• Juvenile Justice Center	55,918,470
• Plaza & Jury Assembly	29,755,500
• Tunnels	5,488,000
• West Dallas Detention Center	31,000,000
• Burnett-Bayland Home Reovations	1,000,000
• Youth Village	1,015,000
• Chimney Rock Replacement	8,900,000
• Aquatics Center	5,400,000
• Probable Cause Court	800,000
• Central Processing Facility	38,000,000
• Fire Training and Sheriff's Academy	9,493,556
• Shooting Range	3,050,000
• Expansion of 1401 Congress Garage	10,377,000
• Old Civil Courts Building	36,025,484
• Roof Repairs -Various Buildings	1,200,000
• Annex 10 and 67	2,800,000
• Annex 14 Replacement Building	14,000,000
• Libraries	5,411,946

## **AWARDS AND ACKNOWLEDGMENTS**

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the County for its Comprehensive Annual Financial Report (CAFR) for the fiscal year ended February 28, 2003. The Certificate of Achievement is a prestigious national award-recognizing conformance with the highest standards for preparation of state and local government financial reports.

In order to be awarded a Certificate of Achievement, a government unit must publish an easily readable and efficiently organized comprehensive annual financial report, whose contents conform to program standards. This report must satisfy both accounting principles generally accepted in the United States and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. The County has received a Certificate of Achievement for the last twenty one years. We believe our current report continues to conform to the Certificate of Achievement program requirements, and we are submitting it for review to GFOA.

The timely completion of this report could not have been achieved without the dedicated efforts of the County Auditor's staff, and the professional services provided by our independent auditors, Deloitte & Touche LLP. I wish to express my gratitude to the Commissioners Court, District Judges, and other County officials and departments for their interest and support in planning and conducting the financial affairs of the County in a responsible and professional manner.

## **REQUEST FOR INFORMATION**

This financial report is designed to provide an overview of the County's finances for individuals who are interested in this information. Questions concerning any of the data 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](http://www.co.harris.tx.us).

Barbara J. Schott, C.P.A.  
County Auditor