

**NORTH HARRIS COUNTY REGIONAL
WATER AUTHORITY**

FINANCIAL STATEMENTS

December 31, 2005



Null-Lairson

CERTIFIED PUBLIC ACCOUNTANTS

PROFESSIONAL CORPORATION

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

Board of Directors
North Harris County Regional Water Authority

We have audited the accompanying statements of net assets of the business type activities of North Harris County Regional Water Authority, as of December 31, 2005 and 2004, and the related statements of revenues, expenses and changes in net assets and cash flows for the years then ended, as listed in the table of contents. These financial statements are the responsibility of North Harris County Regional Water Authority's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the business type activities of North Harris County Regional Water Authority, as of December 31, 2005 and 2004, and the changes in financial position thereof for the years ended, in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis information listed in the table of contents is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

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

Null-Lairson, A.C.

Houston, Texas
April 18, 2006

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MANAGEMENT'S DISCUSSION AND ANALYSIS

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**NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY
MANAGEMENT'S DISCUSSION AND ANALYSIS
December 31, 2005**

Using this Annual Report

Within this section of the financial report of the North Harris County Regional Water Authority (the "Authority"), the Authority's Management provides narrative discussion and analysis of the financial activities of the Authority, for the fiscal year ended December 31, 2005. This analysis should be read in conjunction with the basic financial statements that follow this section.

Overview of the Financial Statements

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

The statement of net assets presents information on all of the Authority's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of changes in the financial position of the Authority.

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

Notes to the Financial Statements

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

**NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY
MANAGEMENT'S DISCUSSION AND ANALYSIS
December 31, 2005**

Financial Analysis of the Authority

The Authority's assets exceeded its liabilities by \$5,028,552 at December 31, 2005, an increase of \$2,112,915 over the previous year. The unrestricted net assets of \$24,866,517 represent amounts available to meet the Authority's future obligations. The Authority has designated \$21,652,193 of this amount for debt service requirements. Most of the Authority's total assets are restricted as to use or are invested in capital assets, which may not be used to liquidate outstanding debt.

The Authority's overall financial position at December 31, 2005 as compared to the two prior years is summarized as follows, based on information contained in the statement of net assets:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Current and other assets	\$ 128,902,722	\$ 94,321,583	\$ 115,557,562
Capital assets	<u>154,923,008</u>	<u>73,179,200</u>	<u>52,906,903</u>
Total assets	283,825,730	167,500,783	168,464,465
Current liabilities	491,314	359,217	2,633,684
Long term liabilities	<u>278,305,864</u>	<u>164,225,929</u>	<u>159,787,556</u>
Total liabilities	278,797,178	164,585,146	162,421,240
Net Assets			
Invested in capital assets, net of related debt	(34,256,626)	(24,687,570)	(22,138,333)
Restricted for debt service	14,418,661	8,740,450	16,219,478
Unrestricted	<u>24,866,517</u>	<u>18,862,757</u>	<u>11,962,080</u>
Total net assets	<u>\$ 5,028,552</u>	<u>\$ 2,915,637</u>	<u>\$ 6,043,225</u>

Amounts reported for 2004 and 2003 have been reclassified to provide a more meaningful comparison with current year amounts.

**NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY
MANAGEMENT'S DISCUSSION AND ANALYSIS
December 31, 2005**

Financial Analysis of the Authority (continued)

The Authority's net operating income for the year ended December 31, 2005 was \$9,071,955 with net non-operating expenses of \$6,959,040 resulted in an increase in net assets of \$2,112,915. Non-operating revenues and non-operating expenses represented interest income from the Authority's investments and interest expense from the Authority's debt. The increase in net assets was primarily the result of the increase in the pumpage fee rate, which was effective April 1, 2005 combined with an unusually dry summer. The rate increase is consistent with the Authority's financial planning and budgeting, and is used to satisfy bond covenants and debt service requirements.

A summarized comparison of the Authority's operations for the year ended December 31, 2005 with the previous two years is as follows, based on information in the statement of activities:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Operating revenues	\$ 13,623,099	\$ 7,918,999	5,927,750
Operating expenses	<u>4,551,144</u>	<u>4,616,393</u>	<u>6,928,643</u>
Net operating income (loss)	9,071,955	3,302,606	(1,000,893)
Net non-operating revenue (expense)	<u>(6,959,040)</u>	<u>(6,430,194)</u>	<u>(1,236,547)</u>
Change in net assets	2,112,915	(3,127,588)	(2,237,440)
Net assets, beginning of year	<u>2,915,637</u>	<u>6,043,225</u>	<u>8,280,665</u>
Net assets, end of year	<u>\$ 5,028,552</u>	<u>\$ 2,915,637</u>	<u>\$ 6,043,225</u>

Amounts reported for 2004 and 2003 have been reclassified to provide a more meaningful comparison with current year amounts.

**NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY
MANAGEMENT'S DISCUSSION AND ANALYSIS
December 31, 2005**

Capital Assets

As of December 31, 2005, the Authority had invested \$154,923,008 (net of accumulated depreciation) in capital assets. These capital assets primarily consist of construction in progress, infrastructure and the Authority's interest in treated water facilities and water transmission facilities.

The Authority's capital assets at December 31, 2005, as compared to the two previous years is summarized as follows:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Capital assets not being depreciated:			
Land and ROW acquisition	\$ 8,104,474	\$ 4,259,132	\$ 1,058,709
Construction in progress	<u>58,028,461</u>	<u>17,747,716</u>	<u>87,391</u>
Total capital assets not being depreciated	66,132,935	22,006,848	1,146,100
 Capital assets being depreciated or amortized:			
Interest in treated water facilities	52,454,277	51,492,844	51,492,844
Interest in transmission facilities	29,187,152		
Infrastructure	10,451,304	1,625,802	36,695
Furniture, computers & equipment	134,693	121,496	193,326
Less accumulated depreciation and amortization	<u>(3,437,353)</u>	<u>(2,067,790)</u>	<u>(772,062)</u>
Total capital assets being depreciated or amortized	<u>88,790,073</u>	<u>51,172,352</u>	<u>50,950,803</u>
Total capital assets	<u>\$ 154,923,008</u>	<u>\$ 73,179,200</u>	<u>\$ 52,096,903</u>

During the current year, \$85,956,261 additional capital assets were added to the Authority; the additional capital assets consisted primarily of land, infrastructure and construction in progress. Additionally capital assets increased attributable to the Authority's acquisition of interest in the Greens Road Water Line and the acquisition of interest in the Charterwood Municipal Utility District water plant expansion (see Note 13).

**NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY
MANAGEMENT'S DISCUSSION AND ANALYSIS
December 31, 2005**

Capital Assets (continued)

Construction has been completed on several projects related to the Groundwater Reduction Plan. Completed projects include those listed below. The approximate cost for these completed projects is \$10 million, which includes some engineering related to these projects and has been recorded, along with related depreciation, in the accompanying statement of net assets.

- Bammel North Houston Supply Line (Project 1C)
- Water Transmission Line on Veterans Memorial Drive (Project 1A-1)
- Water Transmission Line to connect to Bammel North Houston Supply Line (Project 1C-1)
- Pilot Test Hole for Louetta Regional Water Plant (Project 5)

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

- Bammel North Houston Distribution Line (Project 1A)
- Water transmission line on Veterans Memorial Drive to Northwest Harris County Municipal Utility District No. 23 plant. (Project 1A-2)
- Champion Forest Distribution Line (Project 1B)
- Improvements at Northwest Harris County MUD No. 24 water plant (Project 1C-2)
- Cullen Distribution Line – Phase I (Project 4)
- Wells on Louetta Regional Water Plant (Project 5A)
- Well collection line from Louetta Regional Water Plant to Charterwood MUD Water Plant No. 2 (Project 5B)
- Dual 60-inch lines from Louetta Regional Water Plant (Project 5C)
- Louetta Distribution Line – Phase I (Project 6)
- Old Louetta Distribution Line (Project 6A)
- Louetta Distribution Line – Phase 2 (Project 6B-1)
- Ella Distribution Line (Project 7A)
- Extension of Ella Distribution Line to Harris County MUD No. 86 (Project 7A-1)
- Ella/Kuykendahl Distribution Line (Project 7B)
- Louetta Distribution Line, Phase 3 (Project 7C, Contracts 1 and 2)
- Greens Road Water Line (construction and related activities being managed by the City of Houston)
- Supervisory Control and Data Acquisition (SCADA) System (Project 101A)

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

**NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY
MANAGEMENT'S DISCUSSION AND ANALYSIS
December 31, 2005**

Long-Term Obligations

The Authority's total long term obligations at December 31, 2005, as compared to previous years is as follows:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Capital contributions			
2003	32,573,177	32,573,177	32,573,177
2005	14,675,978		
	<u>47,249,155</u>	<u>32,573,177</u>	<u>32,573,177</u>
Revenue bonds			
Series 2003	124,685,000	124,685,000	124,685,000
Series 2005	93,875,000		
Unamortized bond premium	6,868,852	2,434,089	2,518,753
	<u>225,428,852</u>	<u>127,119,089</u>	<u>127,203,753</u>
Accrued compensated absences	92,190	59,182	10,626
	<u>\$272,770,197</u>	<u>\$ 159,751,448</u>	<u>\$ 159,787,556</u>

Total long term obligations increased during 2005 as a result of:

- The issuance of bonds in the amount of \$93,875,000. The bond proceeds will be used to finance the design, acquisition and construction of regional water production, transmission, pumping, storage, distribution and administrative facilities and related realty interests (see Note 5).
- The Authority entered into capital contribution contracts with nineteen water districts, who elected to provide funds to pay capital expenditures of the Authority's system. The participating districts will receive a contribution credit against their respective individual pumpage fees, distributed over the life of the Authority's Series 2005 Senior Lien Revenue Bonds (see Note 6).

During 2005, the Authority has continued to comply with all its bond covenants and maintained its investment grade rating with Moody's and Standard and Poor's.

During the year, the Authority transferred \$4,250,000 from the Revenue Fund to the Coverage Fund, in order to minimize the increase in pumpage fees necessary to satisfy the additional bond and rate covenants.

**NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY
MANAGEMENT'S DISCUSSION AND ANALYSIS
December 31, 2005**

Next Year's Budget

The Authority's 2006 budget as compared to actual results for 2005 is as follows:

	<u>2005 Actual</u>	<u>2006 Budget</u>	Increase (Decrease)
Operating revenues	\$ 13,623,099	\$ 15,196,000	\$ 1,572,901
Operating expenses	<u>4,551,144</u>	<u>4,871,424</u>	320,280
Net operating income	9,071,955	10,324,576	1,252,621
Interest revenues	3,958,239	700,000	(3,258,239)
Interest expense	<u>10,917,279</u>	<u>8,664,543</u>	(2,252,736)
Net non-operating expense	(6,959,040)	(7,964,543)	(1,005,503)
Change in net assets	2,112,915	2,360,033	247,118
Beginning net assets	<u>2,915,637</u>	<u>5,028,552</u>	2,112,915
Ending net assets	<u><u>\$ 5,028,552</u></u>	<u><u>\$ 7,388,585</u></u>	<u><u>2,360,033</u></u>

Economic Factors

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

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

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

**NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY
MANAGEMENT'S DISCUSSION AND ANALYSIS
December 31, 2005**

Economic Factors (continued)

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

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

Request for Information

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

BASIC FINANCIAL STATEMENTS

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NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY
STATEMENTS OF NET ASSETS
December 31, 2005 and 2004

	2005	2004
Assets		
Current assets		
Cash	\$ 49,102	\$ 31,710
Investments	24,481,840	19,237,695
Accounts receivable pumpage fees, net		11,751
Accounts receivable other	919,079	
Total current assets	25,450,021	19,281,156
Noncurrent assets		
Restricted cash and investments	99,544,176	72,540,354
Unamortized bond issuance costs	3,908,525	2,500,073
Capital assets:		
Land and ROW acquisition	8,104,474	4,259,132
Interest in treated water facilities	52,454,277	51,492,844
Interest in transmission facilities	29,187,152	
Infrastructure	10,451,304	1,625,802
Furniture and equipment	134,693	121,496
Construction in progress	58,028,461	17,747,716
Less accumulated depreciation and amortization	(3,437,353)	(2,067,790)
Total noncurrent assets	258,375,709	148,219,627
Total assets	283,825,730	167,500,783
Liabilities		
Current liabilities		
Accounts payable		81,630
Interest payable on bonds	491,314	277,587
Total current liabilities	491,314	359,217
Noncurrent liabilities:		
Accounts payable from restricted assets	3,502,233	3,878,575
Retainage payable from restricted assets	2,033,434	595,906
Accrued compensated absences	92,190	59,182
Capital contributions due in more than one year	47,249,155	32,573,177
Bonds payable due in more than one year (net of unamortized bond premium)	225,428,852	127,119,089
Total noncurrent liabilities	278,305,864	164,225,929
Total liabilities	278,797,178	164,585,146
Net assets		
Invested in capital assets, net of related debt	(34,256,626)	(24,687,570)
Restricted for debt service	14,418,661	8,740,450
Unrestricted	24,866,517	18,862,757
Total net assets	\$ 5,028,552	\$ 2,915,637

See Notes to Financial Statements.

NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
For the Years Ended December 31, 2005 and 2004

	<u>2005</u>	<u>2004</u>
Operating revenues		
Charges for services		
Pumpage fees	\$ 13,600,099	\$ 7,821,005
Other	23,000	97,994
Total operating revenues	<u>13,623,099</u>	<u>7,918,999</u>
 Operating expenses		
Personnel	919,809	807,140
Professional fees	1,518,470	1,747,345
Contracted services	8,933	10,425
Occupancy and office	321,541	317,013
Other	301,386	309,775
Depreciation and amortization	1,481,005	1,424,695
Total operating expenses	<u>4,551,144</u>	<u>4,616,393</u>
 Net operating income	9,071,955	3,302,606
 Non-operating revenues (expenses)		
Interest and fiscal charges expense	(10,917,279)	(7,831,635)
Interest income	3,958,239	1,401,441
Total non-operating expense	<u>(6,959,040)</u>	<u>(6,430,194)</u>
 Change in net assets	2,112,915	(3,127,588)
 Total net assets - beginning	<u>2,915,637</u>	<u>6,043,225</u>
 Total net assets - ending	<u>\$ 5,028,552</u>	<u>\$ 2,915,637</u>

See Notes to Financial Statements.

NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY
STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2005 and 2004

	2005	2004
Cash flows from operating activities		
Receipts from customers	\$ 13,623,099	\$ 7,928,171
Payments for personnel costs	(886,801)	(758,584)
Payments to contractors and vendors	(2,231,960)	(3,329,715)
Net cash provided by operating activities	10,504,338	3,839,872
Cash flows from capital and related financing activities		
Interest paid	(11,302,255)	(9,210,280)
Acquisition and construction of capital assets	(82,052,183)	(17,980,880)
Proceeds from issuance of debt	93,875,000	
Bond issuance costs	(1,507,031)	
Bond discount and premium	4,606,100	
Accrued interest received on sale of bonds	526,606	
Capital contributions	13,656,545	
Net cash provided (used) by capital and related financing activities	17,802,782	(27,191,160)
Cash flows from investing activities		
Interest received	3,958,239	1,401,441
Net cash provided by investing activities	3,958,239	1,401,441
Net increase (decrease) in cash and cash equivalents	32,265,359	(21,949,847)
Balances -beginning of the year	91,809,759	113,759,606
Balances - end of the year	\$ 124,075,118	\$ 91,809,759
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 9,071,955	\$ 3,202,606
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization expense	1,481,005	1,424,695
Capital assets charged to expense		35,329
Change in assets and liabilities:		
(Increase) decrease in accounts receivable		9,172
Decrease in accounts payable	(81,630)	(980,486)
Increase in compensated absences	33,008	48,556
Total adjustments	1,432,383	537,266
Net cash provided by operating activities	\$ 10,504,338	\$ 3,739,872
Cash and cash equivalents per balance sheet:		
Cash	\$ 49,102	\$ 31,710
Investments	24,481,840	854,609
Restricted cash and investments	99,544,176	90,923,440
	\$ 124,075,118	\$ 91,809,759

See Notes to Financial Statements.

NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY
NOTES TO FINANCIAL STATEMENTS
December 31, 2005

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

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

A. Reporting Entity

The Authority is a political subdivision of the State of Texas governed by an elected five member board. As required by generally accepted accounting principles, these financial statements have been prepared based on considerations regarding the potential for inclusion of other entities, organizations or functions as part of the Authority’s financial reporting entity. No other entities, organizations or functions have been included in the Authority’s financial reporting entity. Additionally, as the Authority is considered a primary government for financial reporting purposes, its activities are not considered a part of any other governmental or other type of reporting entity.

Considerations regarding the potential for inclusion of other entities, organizations or functions in the Authority’s financial reporting entity are based on criteria prescribed by generally accepted accounting principles. These same criteria are evaluated in considering whether the Authority is a part of any other governmental or other type of reporting entity. The overriding elements associated with prescribed criteria considered in determining that the Authority’s financial reporting entity status is that of a primary government are: that it has a separate governing body; it is legally separate; and it is fiscally independent of other state and local governments. Additional prescribed criteria under generally accepted accounting principles include; considerations pertaining to organizations for which the primary government is financially accountable; and considerations pertaining to other organizations for which the nature and significance of their relationship with the primary government are such that exclusion would cause the reporting entity’s financial statements to be misleading or incomplete.

NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY
NOTES TO FINANCIAL STATEMENTS
December 31, 2005

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

B. Basic Financial Statements

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

C. Measurement Focus and Basis of Accounting

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

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

Net assets are classified into the following three components:

- Invested in capital assets, net of related debt – this component of net assets consists of capital assets, including restricted capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, notes, capital contribution credits or other borrowings.
- Restricted – this component of net assets consists of constraints placed on net assets used through external constraints imposed by creditors, grantors, contributors or laws or regulations of other governments or through contractual provisions or enabling legislation.
- Unrestricted – this component of net assets consists of net assets that do not meet the definition of the previous two categories.

D. Cash and Investments

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

NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY
NOTES TO FINANCIAL STATEMENTS
December 31, 2005

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

E. Receivables

All receivables are reported at their gross value and, where appropriate, are reduced by an allowance for amounts considered uncollectible. At December 31, 2005 an allowance of \$34,364 was provided for possible uncollectible accounts.

F. Restricted Assets

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

G. Capital Assets

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

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

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

H. Long Term Obligations

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

NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY
NOTES TO FINANCIAL STATEMENTS
December 31, 2005

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

I. Compensated Employee Absences

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

J. Use of Estimates

The preparation of financial statements, in conformity with generally accepted accounting principles, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual amounts could differ from those estimates.

K. Comparative data/reclassifications

Comparative data for the prior year have been presented in order to provide an understanding of the changes in financial position and operations.

NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY
NOTES TO FINANCIAL STATEMENTS
December 31, 2005

NOTE 2 – CASH AND INVESTMENTS

Cash consists of cash on hand and amounts in checking accounts. Investments consist of investments with TexPool, TexPool Prime and TexSTAR. The carrying amounts for cash and investment balances at December 31, 2005 and 2004 consisted of the following:

	<u>2005</u>	<u>2004</u>
Cash		
On hand	\$ 759	\$ 59
Checking accounts	48,343	31,651
	<u>49,102</u>	<u>31,710</u>
Investments		
TexPool	2,829,647	854,609
TexSTAR	21,652,193	
	<u>24,481,840</u>	<u>854,609</u>
Restricted Cash and Investments		
Checking accounts	318,706	172,921
TexPool	36,026,854	12,400,192
TexPool Prime	48,133,362	5,645,700
TexSTAR	15,049,721	72,704,627
	<u>99,528,643</u>	<u>90,923,440</u>
Total Cash and Investments	<u>\$ 124,059,585</u>	<u>\$ 91,809,759</u>

Cash and investments were restricted for the following purposes at December 31, 2005 and 2004:

	<u>2005</u>	<u>2004</u>
Bond reserves	\$ 14,418,661	\$ 8,740,450
Capital improvements	85,125,515	63,799,904
	<u>\$ 99,544,176</u>	<u>\$ 72,540,354</u>

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

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

NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY
NOTES TO FINANCIAL STATEMENTS
December 31, 2005

NOTE 2 – CASH AND INVESTMENTS (continued)

Custodial Credit Risk – Deposits – State statutes and the Authority depository’s agreement require that all amounts deposited in financial institutions be covered by federal depository insurance and, if necessary, pledged collateral. The types of collateral to be pledged to secure the Authority’s funds are defined by state statutes. As of December 31, 2005, all of the Authority’s deposits are insured or fully collateralized.

Investment Credit and Interest Rate Risk - The Authority’s investment policies do not address investment credit and interest rate risk beyond the rating and maturity restrictions in those applicable investments reported above as defined by state statutes. At December 31, 2005, the Authority’s investments in local government pools are rated AAAM and have sixty day weighted average maturity, this investment type comprises 100%.

Investment Pools - The State Comptroller of Public Accounts exercises oversight responsibility of TexPool, the Texas Local Government Investment Pool. Oversight includes the ability to significantly influence operations, designation of management and accountability for fiscal matters. Additionally, the State Comptroller has established an advisory board composed of both participants in TexPool and other persons who do not have a business relationship with TexPool. The Advisory Board members review the investment policy and management fee structure. TexPool is rated AAAM by Standard & Pools. TexPool operates in a manner consistent with the SEC’s Rule 2a7 of the Investment Company Act of 1940. TexSTAR is operated in manner similar to TexPool but is managed by JPMorgan Fleming Asset Management (USA), Inc. and First Southwest Asset Management, Inc. TexPool and TexSTAR use amortized cost rather than market value to report net assets to compute share prices. Accordingly, the fair value of the position in TexPool and TexSTAR is the same as the value of TexPool and TexSTAR shares.

NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY
NOTES TO FINANCIAL STATEMENTS
December 31, 2005

NOTE 3 – CAPITAL ASSETS

A summary of changes in capital assets during the year ended December 31, 2005, follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Retirements Adjustments</u>	<u>Ending Balance</u>
Capital assets not being depreciated:				
Land and ROW acquisition	\$ 4,259,132	\$ 3,845,342	\$	\$ 8,104,474
Construction in progress	<u>17,747,716</u>	<u>43,123,635</u>	<u>2,842,890</u>	<u>58,028,461</u>
Total capital assets not being depreciated	22,006,848	46,968,977	2,842,890	66,132,935
 Capital assets being depreciated or amortized:				
Interest in treated water facilities	51,492,844	961,433		52,454,277
Interest in transmission facilities		29,187,152		29,187,152
Infrastructure	1,625,802	8,825,502		10,451,304
Furniture, computers & equipment	121,496	13,197		134,693
Less accumulated depreciation and amortization	<u>(2,067,790)</u>	<u>(1,369,563)</u>	<u> </u>	<u>(3,437,353)</u>
Total capital assets being depreciated or amortized	<u>51,172,352</u>	<u>37,617,721</u>	<u> </u>	<u>88,790,073</u>
Total capital assets	<u><u>\$ 73,179,200</u></u>	<u><u>\$ 84,586,698</u></u>	<u><u>\$ 2,842,890</u></u>	<u><u>\$ 154,923,008</u></u>

NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY
NOTES TO FINANCIAL STATEMENTS
December 31, 2005

NOTE 3 – CAPITAL ASSETS (continued)

The Authority had the following contractual commitments for construction projects at December 31, 2005:

<u>Contract</u>	<u>Contractual Commitment</u>	<u>Construction in Progress</u>	<u>Remaining Commitment</u>
Bammel North Houston Distribution Line - Project 1A	\$ 8,368,996	\$ 8,135,806	\$ 233,190
Water Transmission Line from Veterans Memorial Drive to NWHC MUD 23 Water Plant - Project 1A2	830,775	767,997	62,778
Champion Forest Distribution Line - Project 1B	3,805,906	3,614,453	191,453
Harris County Municipal Utility District No. 24 Plant Improvements - Project 1C2	1,124,270	747,800	376,470
Louetta Regional Water Plant - Wells 1 and 2 - Project 5A	1,835,000	1,587,261	247,739
Waterline from Louetta Plant to Charterwood Plant - Project 5B	210,785	148,818	61,967
Louetta Distribution Line - Phase I - Project 6	7,836,338	7,799,443	36,895
Old Louetta Distribution Line - Project 6A	2,246,524	1,928,793	317,731
Louetta Distribution Line - Phase II - Project 6B-1	3,456,398	2,418,978	1,037,420
Ella Distribution Line - Project 7A	4,748,945	4,456,514	292,431
Water Line along Ella Blvd. - Project 7A1	849,049	137,020	712,029
Distribution Line at Ella and Kuykendahl - Project 7B	7,651,548	6,720,457	931,091
Louetta Distribution Line - Phase 3 - Project 7C	10,442,100	9,043,427	1,398,673
Waterline Along Louetta Road, Theiss Gully and the Tributary to Spring Gully - Project 7C2	2,187,967	1,690,546	497,421
Total	<u>\$ 55,594,601</u>	<u>\$ 49,197,313</u>	<u>\$ 6,397,288</u>

NOTE 4 - LEASES

In 2000, the Authority entered into a lease for office space. The term of the lease was for five years. The lease was amended effective November 1, 2005 and will terminate on January 31, 2011. The Authority may terminate the lease anytime after thirty-six months, by giving twelve months written notice and by paying a lease termination penalty of \$19,500. The Authority has also entered into various leases for office equipment. The Authority paid \$93,223 under these leases during the current period.

NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY
NOTES TO FINANCIAL STATEMENTS
December 31, 2005

NOTE 4 – LEASES (continued)

The annual commitments for leases are as follows:

<u>Year Ending</u>	<u>Amount</u>
2006	\$ 99,312
2007	92,286
2008	95,911
2009	95,755
2010	107,744
2011	8,895
Total	<u>\$ 499,903</u>

NOTE 5 – LONG-TERM OBLIGATIONS

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

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

During 2005 and 2004, changes in the total amount of the bonds payable were as follows:

	<u>2005</u>	<u>2004</u>
Bonds payable, beginning of year	\$ 124,685,000	\$ 124,685,000
Bonds issued	93,875,000	
Payable, end of year	<u>\$ 218,560,000</u>	<u>\$ 124,685,000</u>

These bonds are reported net of unamortized premium on the statement of net assets. Changes in the unamortized premium during each year were as follows:

	<u>2005</u>	<u>2004</u>
Balance at beginning of year	\$ 2,434,089	\$ 2,518,753
Additions	4,606,100	
Less amortization expense	(171,338)	(84,664)
Balance at end of year	<u>\$ 6,868,851</u>	<u>\$ 2,434,089</u>

NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY
NOTES TO FINANCIAL STATEMENTS
December 31, 2005

NOTE 5 – LONG-TERM OBLIGATIONS (continued)

Bonds payable at December 31, 2005 are comprised of the following issues:

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

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

- Interest and Sinking Fund - Used to accumulate the funds required to make the scheduled payments of debt service on the Senior Bonds. Money in the Interest and Sinking Fund shall be used solely for the purpose of paying principal, interest and any bank charges and other costs associated with payments of debt service on the Senior Bonds. Investments restricted for this fund as of December 31, 2005 were \$9,677,131.
- The Reserve Fund –Used (to the extent that amounts on deposit in the Interest and Sinking Fund and the Coverage Fund are insufficient) to pay the principal and interest on the Senior Bonds as it becomes payable. An insurance surety bond is on hand to secure performance and satisfy bond covenants.
- The Coverage Fund – Used to accumulate funds equal to 25% of the maximum annual debt service requirements for outstanding debt in any fiscal year. As of December 31, 2005, investments restricted by bond covenants for this fund were \$3,916,530, with an additional \$21,652,193 designated by the Authority (see Note 7).
- Operation and Maintenance Reserve Fund – Funds from gross revenues of the Authority will be deposited on or before the last business day of the month into this account. Investments restricted for this fund were \$825,000 as of December 31, 2005.

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

The Authority was in compliance with the bond covenants as of December 31, 2005.

NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY
NOTES TO FINANCIAL STATEMENTS
December 31, 2005

NOTE 5 – LONG-TERM DEBT (continued)

As of December 31, 2005, the debt service requirements on the Senior Bonds outstanding are as follows:

<u>Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Totals</u>
2006	\$	\$ 11,054,556	\$ 11,054,556
2007		11,054,556	11,054,556
2008		11,054,556	11,054,556
2009		11,054,556	11,054,556
2010	4,605,000	11,054,556	15,659,556
2011	4,810,000	10,851,981	15,661,981
2012	5,025,000	10,635,356	15,660,356
2013	5,275,000	10,384,106	15,659,106
2014	5,545,000	10,115,156	15,660,156
2015	5,835,000	9,824,044	15,659,044
2016	6,145,000	9,517,706	15,662,706
2017	6,470,000	9,195,094	15,665,094
2018	6,810,000	8,855,418	15,665,418
2019	7,165,000	8,497,893	15,662,893
2020	7,540,000	8,121,731	15,661,731
2021	7,935,000	7,725,881	15,660,881
2022	8,355,000	7,309,293	15,664,293
2023	8,775,000	6,883,293	15,658,293
2024	9,225,000	6,435,868	15,660,868
2025	9,685,000	5,974,618	15,659,618
2026	10,175,000	5,490,368	15,665,368
2027	10,680,000	4,981,618	15,661,618
2028	11,215,000	4,447,618	15,662,618
2029	11,775,000	3,886,868	15,661,868
2030	12,360,000	3,298,118	15,658,118
2031	12,980,000	2,680,118	15,660,118
2032	13,635,000	2,031,118	15,666,118
2033	14,315,000	1,349,368	15,664,368
2034	5,960,000	626,531	6,586,531
2035	6,265,000	321,081	6,586,081
Totals	<u>\$ 218,560,000</u>	<u>\$ 214,713,024</u>	<u>\$ 433,273,024</u>

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

NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY
NOTES TO FINANCIAL STATEMENTS
December 31, 2005

NOTE 5 – LONG-TERM DEBT (continued)

Compensated Absences - The Authority's liability for compensated absences changed as follows:

	2005	2004
Balance at beginning of year	\$ 59,182	\$ 10,626
Increase in liability	92,190	59,182
Decrease in liability	(59,182)	(10,626)
Balance at end of year	\$ 92,190	\$ 59,182

NOTE 6 – CAPITAL CONTRIBUTIONS

In 2003, the Authority entered into contracts with twenty-four Municipal Utility Districts (MUDs) to provide funds to pay capital expenditures of the Authority's system. Each MUD has paid a Capital Contribution based on a percentage of its pro-rata share of the total groundwater production for all water utilities during the calendar year 2002. Capital contributions of \$32,573,177 were made to the Authority in the 2003 fiscal year. The participating MUDs began receiving contribution credits against their individual pumpage fees distributed over the life of the Series 2003 Senior Bonds beginning with the 2003 third quarter pumpage fees which were reported and collected during 2004 and 2005. Any amounts remaining plus accrued interest at the end of the capital contribution expiration date will be credited against any amounts owed to the Authority by the MUDs or paid to the MUDs by the Authority.

In 2005, the Authority entered into agreements with nineteen MUDs. Capital contributions of \$13,756,899 were made to the Authority in the 2005 fiscal year. An additional capital contribution was received in January 2006 for \$919,079, and has been recorded in the statement of Net Assets as an accounts receivable. The Authority recorded a total of \$14,675,978 which has been recorded as capital contributions in the current period. The participating MUDs began receiving contribution credits against their individual pumpage fees distributed over the life of the Series 2005 Senior Bonds beginning with the 2005 third quarter pumpage fees, which were reported and collected in 2005. As with the 2003 contribution credits, any amounts remaining plus accrued interest at the end of the capital contribution date will be credited against any amounts owed to the Authority by the MUDs or paid to the MUDs by the Authority.

NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY
NOTES TO FINANCIAL STATEMENTS
December 31, 2005

NOTE 6 – CAPITAL CONTRIBUTIONS (continued)

Future contribution credits including interest at the effective interest rate of the 2003 Senior Bonds as of December 31, 2005 are as follows:

<u>Year</u>	<u>Contribution Credits</u>	<u>Year</u>	<u>Contribution Credits</u>
2006	\$ 1,647,402	2020	\$ 2,373,821
2007	1,647,402	2021	2,373,821
2008	1,647,402	2022	2,373,821
2009	1,647,402	2023	2,373,821
2010	2,373,821	2024	2,373,821
2011	2,373,821	2025	2,373,821
2012	2,373,821	2026	2,373,821
2013	2,373,821	2027	2,373,821
2014	2,373,821	2028	2,373,821
2015	2,373,821	2029	2,373,821
2016	2,373,821	2030	2,373,821
2017	2,373,821	2031	2,373,821
2018	2,373,821	2032	2,373,821
2019	2,373,821	2033	2,373,821
		Totals	<u><u>\$63,561,312</u></u>

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

<u>Year</u>	<u>Contribution Credits</u>	<u>Year</u>	<u>Contribution Credits</u>
2006	\$ 702,962	2021	\$ 1,000,879
2007	705,724	2022	1,000,879
2008	705,724	2023	1,000,879
2009	705,724	2024	1,000,879
2010	1,000,879	2025	1,000,879
2011	1,000,879	2026	1,000,879
2012	1,000,879	2027	1,000,879
2013	1,000,879	2028	1,000,879
2014	1,000,879	2029	1,000,879
2015	1,000,879	2030	1,000,879
2016	1,000,879	2031	1,000,879
2017	1,000,879	2032	1,000,879
2018	1,000,879	2033	1,000,879
2019	1,000,879	2034	1,000,879
2020	1,000,879	2035	1,000,879
		Totals	<u><u>\$28,842,988</u></u>

NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY
NOTES TO FINANCIAL STATEMENTS
December 31, 2005

NOTE 7 – UNRESTRICTED NET ASSETS

Included in the Authority's unrestricted net assets of \$24,866,517, is \$21,652,193 which the Authority has designated as additional bond reserves. These funds have been deposited in the coverage fund discussed in Note 5.

NOTE 8 - RISK MANAGEMENT

The Authority is exposed to various risks related to torts: theft of, damage to and destruction of assets; errors and omissions; and natural disasters. The Authority's risk management program encompasses various means of protecting the Authority against loss by obtaining property, casualty and liability coverage through commercial insurance carriers.

NOTE 9 – DEFERRED COMPENSATION PLANS

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

NOTE 10 – PENSION PLAN

The Authority has established the North Harris County Regional Water Authority Qualified Pension Plan 401(a) (the "Plan"). The Plan covers all employees. Under the terms of the Plan, active participants become 100% vested on the fifth anniversary of employment. Participants are eligible for payment of benefits upon reaching age 65, becoming disabled or separating from service for any other reason. Benefits are distributed in accordance with the instructions of the participants. The Board of Directors appointed ICMA-RC to serve as Plan administrator and trustee. The Plan provides for a minimum Authority contribution of 7% of total current covered payroll. At December 31, 2005, all of the Authority's employees were members of the Plan. Non-vested contributions are immaterial to total contributions at December 31, 2003. Vested contributions are solely the possession of participating employees. Total current payroll was \$657,472 for the year ended December 31, 2005, of which the entire amount was covered under the Plan. Employer contributions to the Plan for the year ended December 31, 2005 were \$68,888.

In 2003, the Authority established an additional 401(a) plan for management employees only. It is identical to the above plan with the following exceptions: 1) management employees are fully vested on the second anniversary of employment and 2) the Plan provides for a minimum Authority contribution of 17% for the current year annual covered payroll of the General Manager. The total payroll and employer contributions for this plan are included in the totals above.

NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY
NOTES TO FINANCIAL STATEMENTS
December 31, 2005

NOTE 11 – WATER SUPPLY CONTRACTS

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

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

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

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

In March 2003, the Authority entered into an Interim Treated Water Supply Contract with Houston. Subject to the terms of this contract, the Authority entered into an agreement with Emerald Forest Utility District (the "District") for water supply. In the 2003 fiscal year, the Authority reimbursed the District \$36,694 for the cost of constructing a water line to the City of Houston's line. During the current year, the Authority paid Houston \$50,784 on behalf of the District for purchased water.

NOTE 12 – AGREEMENT FOR JOINT FINANCING OF FACILITIES

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

NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY
NOTES TO FINANCIAL STATEMENTS
December 31, 2005

NOTE 12 – AGREEMENT FOR JOINT FINANCING OF FACILITIES (continued)

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

NOTE 13 – INTERLOCAL AGREEMENTS

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

NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY
NOTES TO FINANCIAL STATEMENTS
December 31, 2005

NOTE 13 – INTERLOCAL AGREEMENTS (continued)

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

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

NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY
NOTES TO FINANCIAL STATEMENTS
December 31, 2005

NOTE 14 – BUY/SELL AGREEMENTS

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

NOTE 14 – SUBSEQUENT EVENT

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

NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY
NOTES TO FINANCIAL STATEMENTS
December 31, 2005

NOTE 14 – SUBSEQUENT EVENT (continued)

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

SUPPLEMENTARY INFORMATION

NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY
SCHEDULE OF EXPENSES
Last Four Fiscal Years

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

NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY
SCHEDULE OF EXPENSES
Last Four Fiscal Years

	2005	2004	2003	2002
Other				
Director fees	\$ 26,550	\$ 32,400	\$ 28,500	\$ 29,850
Election expense				60,248
Bulk water purchases	50,784	22,793	9,154	
Technology transfer projects	42,363	54,472	117,794	
Insurance	12,678	11,775	4,924	6,540
Travel and per diem	31,241	27,291	19,343	17,976
Legal notices		2,627	5,774	161
Membership/Subscription fees	5,423	5,922	5,028	3,951
Computer services	11,398	13,561	14,504	8,883
Computer software and equipment	9,701	30,306		345
Maintenance and repairs	5,445	15,513	15,772	21,482
Book and covers			8,036	8,547
Office furniture	10,610	17,547		
Public education	23,279	10,200		823
Water conservation	50,941	52,757		
Mileage reimbursement	4,220	5,044	3,747	8,618
Permit fees	7,559	200	1,400	
Seminars/training	5,435	6,351	4,500	7,623
Security	3,281	517	416	790
Miscellaneous	478	499	1,019	556
	<u>301,386</u>	<u>309,775</u>	<u>239,911</u>	<u>176,393</u>
Depreciation and Amortization	<u>1,481,005</u>	<u>1,424,695</u>	<u>685,531</u>	<u>41,465</u>
Total Expenses	<u>\$ 4,551,144</u>	<u>\$ 4,616,393</u>	<u>\$ 6,928,643</u>	<u>\$ 2,398,784</u>

**NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY
SCHEDULE OF PRINCIPAL WATER USERS
December 31, 2005**

<u>Name</u>	<u>Pumpage (gallons)</u>	<u>Pumpage Fees Paid</u>	<u>Share (%)</u>
Tomball, City of	726,857,000	\$ 397,118	2.5638%
Harris Co. FWSD 61	701,096,000	384,902	2.4729%
Harris Co. MUD 358	635,284,941	356,625	2.2408%
Cypress Forest PUD	552,166,169	307,850	1.9476%
AquaSource, Inc.	540,983,530	299,438	1.9081%
Harris Co. WCID 109	520,306,000	283,683	1.8352%
Harris Co. MUD 365	513,848,000	288,338	1.8124%
Faulkey Gully MUD	493,939,242	267,752	1.7422%
NW HC MUD 5	460,644,000	259,318	1.6248%
Harris Co. MUD 24	446,085,000	244,938	1.5734%
Subtotal	<u>5,591,209,882</u>	<u>3,089,962</u>	<u>19.7212%</u>
All other retail utilities	21,026,888,225	11,506,095	74.1658%
All private well owners	<u>1,733,097,050</u>	<u>984,581</u>	<u>6.1130%</u>
Total	<u><u>28,351,195,157</u></u>	<u><u>\$ 15,580,638</u></u>	<u><u>100.0000%</u></u>

**NORTH HARRIS COUNTY REGIONAL WATER AUTHORITY
MISCELLANEOUS INFORMATION
December 31, 2005**

Rates and Charges

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

Billing and Collection Experience

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