

**HARRIS COUNTY  
IMPROVEMENT DISTRICT NO. 1**

**ANNUAL FINANCIAL AND  
COMPLIANCE REPORT**

**Year Ended June 30, 2016  
with Independent Auditor's Report**



# HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

## FINANCIAL REPORT

Year Ended June 30, 2016

### Table of Contents

<b>Independent Auditor's Report</b>	1
<b>Management's Discussion and Analysis</b>	5
<b>Basic Financial Statements:</b>	
Government-wide Financial Statements:	
Statement of Net Position	14
Statement of Activities	15
Governmental Fund Financial Statements	
Balance Sheet - Governmental Funds	16
Reconciliation of the Governmental Funds Balance Sheet to the Statement of Net Position	17
Statement of Revenues, Expenditures and Changes in Fund Balance - Governmental Funds	18
Reconciliation of the Statement of Revenues, Expenditures and Changes in Fund Balances of Governmental Funds to the Statement of Activities	19
Notes to the Financial Statements	20
<b>Required Supplementary Information:</b>	
Schedule of Revenues, Expenditures and Changes in Fund Balance - Budget to Actual	35
Notes to Required Supplementary Information	36
<b>Federal Awards Section</b>	
Independent Auditor's Report on Internal Control over Financial Reporting and Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing         Standards</i>	37
Independent Auditor's Report on Compliance For Each Major Federal Program and on Internal Control Over Compliance Required by the OMB Uniform Guidance	39
Schedule of Findings and Questioned Costs	41
Schedule of Expenditures of Federal Awards	43
Notes to the Schedule of Expenditures of Federal Awards	44



## INDEPENDENT AUDITOR'S REPORT

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

### Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities and each major fund of Harris County Improvement District No. 1 (the "District") as of and for the year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the District's basic financial statements as listed in the table of contents.

### Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

## **Opinions**

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and each major fund of the District as of June 30, 2016, and the respective changes in financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

## **Other Matters**

### *Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 7 through 12 and the Schedule of Revenues, Expenditures and Changes in Fund Balance – Budget to Actual on pages 35 through 36 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

### *Other information*

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the District's basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis, as required by Title 2 U.S. *Code of Federal Regulations (CFR) Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* and is not a required part of the basic financial statements.

The schedule of expenditures of federal awards is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of expenditures of federal awards is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Board of Directors  
Harris County Improvement District No. 1

**Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated December 6, 2016, on our consideration of the District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the District's internal control over financial reporting and compliance.

*Whitley Penn LLP*

Houston, Texas  
December 6, 2016

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## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

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# HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

## MANAGEMENT'S DISCUSSION AND ANALYSIS

Year Ended June 30, 2016

As management of the Harris County Improvement District No. 1 (the "District"), we offer readers of the District's financial statements this narrative overview and analysis of the financial activities of the District for the fiscal year ended June 30, 2016. The fiscal year starts on July 1, 2015 and ends on June 30, 2016.

### Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the District's basic financial statements. The District's basic financial statements comprise three components: (1) government-wide financial statements, (2) fund financial statements and (3) notes to the financial statements. This report also contains required supplementary information in addition to the basic financial statements themselves.

### Government-wide Financial Statements

The government-wide financial statements are designed to provide readers with a broad overview of the District's finances, in a manner similar to a private-sector business.

The *Statement of Net Position* presents information on all of the District's assets and liabilities, and deferred outflows of resources with the difference reported as net position. Over time, increases or decreases in net position may serve as a useful indicator regarding the financial position of the District. Other factors that are not included in the financial statements, such as increased tax base in the District's boundaries, should be considered in evaluating the condition of the District's overall financial position.

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

### Fund Financial Statements

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The District, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

The District maintains three individual governmental funds. Information is presented separately in the *Governmental Fund Balance Sheet* and in the *Governmental Fund Statement of Revenues, Expenditures and Changes in Fund Balances* for the General Fund, the Debt Service Fund, and the Capital Projects Fund, all of which are considered to be major funds.

Fund financial statements are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements. Because the focus of governmental funds is narrower than that of the government-wide financial statements, it may be useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the *Governmental Fund Balance Sheet* and the *Governmental Fund Statement of Revenues, Expenditures and Changes in Fund Balances* provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

**HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1**

**MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**

**Notes to the Financial Statements**

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements.

**Government-wide Financial Analysis**

In the government-wide statements, the difference between assets and deferred outflows and liabilities is called net position. As previously noted, net position may serve over time as a useful indicator of a government's financial position. The District's net position at June 30, 2016, was \$2,659,379.

Net position is categorized based on the availability to provide financial resources for the District. Net position that is "Investment in capital assets" represent the District's investments in capital assets, less any debt used to acquire those assets that is still outstanding. Resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities. "Restricted" net position represents amounts that are restricted for future debt service requirements. "Unrestricted" net position represents amounts available to meet the District's future obligations.

At year-end, the District had total assets of \$32,153,004 and deferred outflows of \$144,478. Of this amount, \$27,559,888 consisted of cash and cash equivalents and \$3,666,282 of capital assets. The change in capital assets consisted of capital outlay of \$1,457,400, net of depreciation of \$205,553. Total liabilities were \$29,638,103 as of year-end. Of this amount, \$26,626,939 consisted of long-term debt and accrued interest. The balance of the liabilities consists of accounts payable and other accrued liabilities and expenses. A comparative summary of the District's overall financial position, as of June 30, 2016 and 2015, is as follows:

	<u>2016</u>	<u>2015</u>
Current and other assets	\$ 28,486,722	\$ 8,174,696
Capital assets	3,666,282	1,800,256
<b>Total Assets</b>	<u>32,153,004</u>	<u>9,974,952</u>
Deferred Charge on Refunding	144,478	164,614
<b>Total Deferred outflows</b>	<u>144,478</u>	<u>164,614</u>
Other liabilities	3,249,169	1,801,723
Long-term liabilities	26,388,934	8,298,691
<b>Total Liabilities</b>	<u>29,638,103</u>	<u>10,100,414</u>
Net position:		
Investment in capital assets	3,666,282	1,800,256
Restricted	2,170,888	1,148,835
Unrestricted	(3,177,791)	(2,909,939)
<b>Total Net Position</b>	<u>\$ 2,659,379</u>	<u>\$ 39,152</u>

**HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1**

**MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**

**Government-wide Financial Analysis - continued**

The total net position of the District increased by \$2,006,048. A comparative summary of the District's statement of activities for the past two years is as follows:

	<u>2016</u>	<u>2015</u>
<b>Revenues</b>		
Program revenue		
Charges for services	\$ 2,240,008	\$ 1,418,232
Capital Grants	1,275,311	4,688,550
General revenues		
Property taxes	7,806,719	7,619,248
Unrestricted investment earnings	55,715	15,723
Total Revenues	<u>11,377,753</u>	<u>13,741,753</u>
<b>Expenses</b>		
General and administrative	3,118,658	2,804,728
Traffic control	1,330,192	1,739,788
Maintenance and beautification	1,853,561	1,781,585
Planning and engineering	60,953	138,446
Marketing and communications	853,083	787,931
Interest on long-term debt	811,998	239,644
Economic development	67,949	90,500
Transfers to other governments	1,275,311	4,688,550
Total Expenses	<u>9,371,705</u>	<u>12,271,172</u>
Increase (decrease) in net position	2,006,048	1,470,581
Net position - as previously reported	39,152	(1,431,429)
Prior period adjustment	614,179	-
Net position - ending	<u>\$ 2,659,379</u>	<u>\$ 39,152</u>

**Financial Analysis of the Government's Funds**

The focus of the District's governmental funds is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the District's financing requirements. In particular, unassigned fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

As of the end of the current fiscal year, the District's governmental funds reported combined ending fund balances of \$27,482,918, an increase of \$20,368,858 in comparison with the prior year. This is due to increase in property tax revenues. The unassigned portion of fund balance is \$6,233,485. This amount is available for spending at the government's discretion. The remainder of fund balance is restricted to indicate that it is not available for new spending because it has already been restricted for capital projects of \$18,788,836, debt service of \$2,360,727, and nonspendable fund balance of \$99,870 related to prepaid items.

**HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1**

**MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**

**Financial Analysis of the Government's Funds - continued**

The following is a summary of changes in fund balances for the prior two fiscal years:

	2016	Increase (Decrease)	2015	Increase (Decrease)	2014
General Fund	\$ 6,333,355	\$ 165,369	\$ 6,167,986	\$ 860,894	\$ 5,307,092
Capital Projects Fund	18,788,836	19,041,215	(252,379)	1,132	(253,511)
Debt Service Fund	2,360,727	1,162,274	1,198,453	11,007	1,187,446
	<u>\$ 27,482,918</u>	<u>\$ 20,368,858</u>	<u>\$ 7,114,060</u>	<u>\$ 873,033</u>	<u>\$ 6,241,027</u>

The General Fund is the chief operating fund of the District. Fund balance in the General Fund increased by \$165,369 during the current fiscal year including a prior period adjustment to decrease fund balance by \$351,815. This increase is due to increases in property tax revenue and is offset by the prior period adjustment. The prior period adjustment is due to write-off of a receivable balance from the Capital Fund for design costs incurred in previous years. As a measure of the General Fund's liquidity, it may be useful to compare unassigned fund balance to total fund expenditures. At the end of the current fiscal year, the unassigned portion of fund balance of the General Fund was \$6,233,485, while expenditures for the year were \$7,104,447.

The Debt Service Fund has a total fund balance of \$2,360,727, all of which is restricted for the payment of debt service. The increase in fund balance during the current year in the Debt Service Fund was \$1,162,274.

The Capital Projects Fund has total fund balance of \$18,788,836. The increase in the fund balance during the current year in the Capital Projects Fund of \$19,041,215 including a prior period adjustment to increase fund balance by \$351,815. The increase is primarily related to issue of Bond series 2015.

**General Fund Budgetary Highlights**

The Board of Directors did not amend the budget during the year. The District anticipated an increase in the fund balance of \$33,490, while the actual was an increase of \$165,369. Variances between budget and actual were due primarily to budget variances in property tax revenues and operational spending.

**Debt Administration**

At June 30, 2016 and 2015, the District had total bonded debt outstanding as shown below:

Series	2016	2015
Series 2013	\$ 7,710,000	\$ 8,505,000
Series 2015	20,365,000	-
	<u>\$ 28,075,000</u>	<u>\$ 8,505,000</u>

## **HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1**

### **MANAGEMENT'S DISCUSSION AND ANALYSIS (*continued*)**

#### **Economic Factors and Next Year's Budgets and Rates**

The District is a political subdivision of the State of Texas, created in 1987 by a special act of the 70<sup>th</sup> Texas Legislature. The District levies an ad valorem tax on real and personal property within its boundaries. The tax rate for tax year 2015 was \$0.14345 per \$100 of assessed value. The tax rate will remain the same for tax year 2016, with expected revenues of approximately \$6.0 million.

#### **Office Space**

Uptown Houston is one of the largest business districts outside a historic core in the United States. It is the 17<sup>th</sup> largest business district in the United States: comparable to Denver and Cleveland. With over 26 million square feet of total office space in its market area, Uptown accounts for over 9% of Houston MSA's total 'Class A' office space with almost 13 million square feet. There are 115,000 office employees in the Uptown market area. At the end of the second quarter, 2016, class A office space was 87% leased compared to Houston's total office market with occupancy at 83.9%.

Overall, 2015 certified ad valorem values for the office sector were approximately 7% higher than 2014 values. The Uptown market area welcomed the new Nelson-Murphree office tower with 165,000 SF and will soon welcome two other additions to the office sector: the 600,000 SF BHP Billiton tower at 1360 Post Oak Boulevard (located in the TIRZ) and the 350,000 SF Amegy office tower at 1717 West Loop South. During this fiscal year, Landry's broke ground on its 36-story mixed-use vertical building (also in the TIRZ) with 140,000 SF of boutique office space close to Post Oak Boulevard and the 610 West Loop. The project is expected to be completed late 2017.

#### **Retail**

Uptown is synonymous with shopping and is known as a world-renowned center for retail. Ad valorem values for the retail sector were certified over 6% higher 2015. Retail was 99% leased as of Q2 2016. This market maintained as The Galleria is now the fourth largest retail center in the United States. The 22-acre mixed-use development known as BLVD Place boasting over 200,000 square feet of retail and office is now open. The Galleria Mall continues its reconstruction and renovation valued at \$250,000,000 at the corner of Westheimer and Sage. Totally redesigned, Saks Fifth Avenue is now open and their former space is being remodeled for smaller high-end retail tenants. Further, the 200,000 square foot retail component of the River Oaks District, situated in the Uptown market area, is also now open.

#### **Hotel**

Uptown now has 33 first quality hotels in the area, offering almost 7,600 rooms for guests. Ad valorem values for this sector were certified 5% higher in 2015. The Hyatt Regency and the Hyatt Place are now open and have added an additional 482 rooms. Landry's 36 story mixed-use development called "The Post Oak" recently broke ground and will add another 240 rooms when completed in 2017.

The area's RevPAR (revenues per available room) for 2016 Q2 is \$114.83 and comparable to the Houston Central Business District at \$128.90. The RevPAR for Houston City-wide is \$73.29. Uptown Houston also boasts one of the highest occupancy rates in the city at 71.6%, while the Houston City-wide occupancy rate was 66.2% at the end of the second quarter, 2016.

## **HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1**

### **MANAGEMENT'S DISCUSSION AND ANALYSIS (*continued*)**

#### **Residential**

In 2015, five new high-rise residential towers delivered totally over 1,500 units with 2016 set to deliver another 2,000 units before year's end. Single-family properties are holding values with some properties increasing slightly. This year, three new multi-family projects opened adding more than \$100 million dollars of value to the tax roll. Residential activity continues in the area. Already under construction, 2017 will see another 900 units delivered, including Trammel Crow's new 400 unit "Alexan 5151". Hanover's 355 unit luxury apartments just completed and is ahead of projected occupancy. Uptown Houston is one of the most prestigious and desirable areas to live.

The economic outlook is positive in Uptown. In 2016, the ad valorem values were up over 7% from the previous year and Uptown remains a viable district. While economic factors (property values, vacancy rates, future development, etc.) impact the size of debt issues, management takes a conservative approach to ensure that adequate resources are available to support the projects within the District.

#### **Requests for Information**

This financial report is designed to provide a general overview of the Harris County Improvement District No. 1's finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to Harris County Improvement District No. 1, 1980 Post Oak Boulevard #1700, Houston, Texas 77056.

## **BASIC FINANCIAL STATEMENTS**

# HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

## STATEMENT OF NET POSITION - GOVERNMENTAL ACTIVITIES

June 30, 2016

### Assets

Cash and temporary investments	\$ 27,559,888
Restricted Cash	107,996
Property taxes receivable	181,772
Due from other governments	523,837
Other receivables	13,359
Prepaid expenses	99,870
Construction in progress	1,457,400
Capital assets, net of depreciation	<u>2,208,882</u>
Total Assets	<u>32,153,004</u>

### Deferred Outflows of Resources

Deferred Charge on Refunding	<u>144,478</u>
Total Deferred Outflows of Resources	<u>144,478</u>

### Liabilities

Accounts payable and accrued expenses	714,036
Other payables	107,996
Accrued interest	238,005
Noncurrent liabilities:	
Due in less than one year	2,189,132
Due in more than one year	<u>26,388,934</u>
Total Liabilities	<u>29,638,103</u>

### Net Position

Investment in capital assets	3,666,282
Restricted for debt service	2,170,888
Unrestricted	<u>(3,177,791)</u>
Total Net Position	<u>\$ 2,659,379</u>

See notes to the Financial Statements.

**HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1**

**STATEMENT OF ACTIVITIES - GOVERNMENTAL ACTIVITIES**

**For the Year Ended June 30, 2016**

<u>Functions/Programs</u>	<u>Expenses</u>	<u>Program Revenue</u>		<u>Net (Expense) Revenue and Changes in Net Position</u>
		<u>Charges for Services</u>	<u>Capital Grants</u>	
General and administrative	\$ 3,118,658	\$ 1,573,264	\$ -	\$ (1,545,394)
Traffic Control	1,330,192	-	-	(1,330,192)
Maintenance and beautification	1,853,561	666,744	-	(1,186,817)
Planning and engineering	60,953	-	-	(60,953)
Marketing and communication	853,083	-	-	(853,083)
Interest on long-term debt and other charges	811,998	-	-	(811,998)
Economic development	67,949	-	-	(67,949)
Construction on behalf of the City of Houston	-	-	1,275,311	1,275,311
Transfers to other governments - Uptown Development Authority	1,275,311	-	-	(1,275,311)
<b>Total activities</b>	<u>\$ 9,371,705</u>	<u>\$ 2,240,008</u>	<u>\$ 1,275,311</u>	<u>(5,856,386)</u>

General revenues:	
Property taxes	7,806,719
Unrestricted investment earnings	<u>55,715</u>
Total general revenues and transfers	<u>7,862,434</u>
Change in net position	2,006,048
Net position - beginning	39,152
Prior period adjustment	<u>614,179</u>
Net position - ending	<u>\$ 2,659,379</u>

See notes to the Financial Statements.

**HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1**

**BALANCE SHEET - GOVERNMENTAL FUNDS**

**June 30, 2016**

	<u>General Fund</u>	<u>Capital Projects</u>	<u>Debt Service</u>	<u>Total Governmental Funds</u>
<b>Assets</b>				
Cash	\$ 6,359,969	\$ 18,876,474	\$ 2,323,445	\$ 27,559,888
Restricted Cash	107,996	-	-	107,996
Taxes receivable	133,606	-	48,166	181,772
Due from other funds	-	-	42,370	42,370
Due from other governments	169,231	136,318	-	305,549
Other receivables	-	218,288	-	218,288
Due from others	13,359	-	-	13,359
Prepaid items	99,870	-	-	99,870
Total Assets	<u>\$ 6,884,031</u>	<u>\$ 19,231,080</u>	<u>\$ 2,413,981</u>	<u>\$ 28,529,092</u>
<b>Liabilities and Deferred Inflows</b>				
<b>Liabilities:</b>				
Accounts payable	\$ 309,074	\$ 399,874	\$ 5,088	\$ 714,036
Due to other funds	-	42,370	-	42,370
Other payables	107,996	-	-	107,996
Total Liabilities	<u>417,070</u>	<u>442,244</u>	<u>5,088</u>	<u>864,402</u>
<b>Deferred Inflows of Resources</b>				
Unavailable Revenues - Property Taxes	133,606	-	48,166	181,772
Total Deferred Inflows of Resources	<u>133,606</u>	<u>-</u>	<u>48,166</u>	<u>181,772</u>
<b>Fund balances:</b>				
Restricted for:				
Nonspendable	99,870	-	-	99,870
Restricted	-	18,788,836	2,360,727	21,149,563
Unassigned	6,233,485	-	-	6,233,485
Total Fund Balances	<u>6,333,355</u>	<u>18,788,836</u>	<u>2,360,727</u>	<u>27,482,918</u>
Total Liabilities, Deferred Inflows of Resources, and Fund Balances	<u>\$ 6,884,031</u>	<u>\$ 19,231,080</u>	<u>\$ 2,413,981</u>	<u>\$ 28,529,092</u>

See notes to the Financial Statements.

**HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1**

**RECONCILIATION OF THE GOVERNMENTAL FUNDS  
BALANCE SHEET TO THE STATEMENT OF NET POSITION**

**June 30, 2016**

**Total fund balance, governmental funds** \$ 27,482,918

Amounts reported for governmental activities in the Statement of Net Position are different because:

Capital assets used in governmental activities are not financial resources and, therefore, are not reported as assets in governmental funds.

Capital assets at historical cost	\$ 16,052,719	
Less accumulated depreciation	<u>(13,843,837)</u>	
Change due to capital assets		3,666,282

Property taxes receivable and related penalties and interest have been levied and are due, but are not available soon enough to pay current period expenditures and therefore, are deferred in the funds.

Property taxes receivable	121,608	
Penalty and interest receivable	<u>60,164</u>	
Change due to property taxes		181,772

Some liabilities and deferred outflows are not due and payable in the current period and are not included in the fund financial statements, but are included in the Statement of Net Position. These are as follows:

Bonds payable	(28,075,000)	
Deferred charge on refunding	144,478	
Unamortized premiums	(430,670)	
Accrued interest	(238,005)	
Compensated absences	<u>(72,396)</u>	
Change due to long-term obligations		<u>(28,671,593)</u>

**Net Position of Governmental Activities in the Statement of Net Position** \$ 2,659,379

See notes to the Financial Statements.

**HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1**

**STATEMENT OF REVENUES, EXPENDITURES  
AND CHANGES IN FUND BALANCES - GOVERNMENTAL FUNDS**

**For the Year Ended June 30, 2016**

	<u>General Fund</u>	<u>Capital Projects</u>	<u>Debt Service</u>	<u>Total Governmental Funds</u>
<b>Revenues</b>				
Property taxes	\$ 5,447,948	\$ -	\$ 2,310,672	\$ 7,758,620
Intergovernmental	1,573,264	1,275,311	-	2,848,575
Investment earnings	15,708	36,793	3,214	55,715
Other Income	666,744	-	-	666,744
<b>Total Revenues</b>	<u>7,703,664</u>	<u>1,312,104</u>	<u>2,313,886</u>	<u>11,329,654</u>
<b>Expenditures</b>				
<b>Current:</b>				
Planning and engineering	60,953	-	-	60,953
Traffic control	1,127,139	-	-	1,127,139
Maintenance and beautification	1,853,561	-	-	1,853,561
General and administrative	3,144,262	-	-	3,144,262
Marketing and communications	850,583	-	-	850,583
Economic development	67,949	-	-	67,949
<b>Debt Service:</b>				
Principal	-	-	795,000	795,000
Interest and other charges	-	337,026	356,612	693,638
<b>Capital Outlay</b>	-	1,457,400	-	1,457,400
Transfers to other governments - Uptown Development Authority	-	1,275,311	-	1,275,311
<b>Total Expenditures</b>	<u>7,104,447</u>	<u>3,069,737</u>	<u>1,151,612</u>	<u>11,325,796</u>
Excess (deficiency) of Revenues over Expenditures	<u>599,217</u>	<u>(1,757,633)</u>	<u>1,162,274</u>	<u>3,858</u>
<b>Other Financing Sources/(Uses):</b>				
Proceeds from long-term debt	-	20,365,000	-	20,365,000
Transfers in	-	82,033	-	82,033
Transfers out	(82,033)	-	-	(82,033)
<b>Total Other Financing Sources/(Uses)</b>	<u>(82,033)</u>	<u>20,447,033</u>	<u>-</u>	<u>20,365,000</u>
Net change in Fund Balances	517,184	18,689,400	1,162,274	20,368,858
Fund Balances - beginning of year	6,167,986	(252,379)	1,198,453	7,114,060
Prior period adjustment	(351,815)	351,815	-	-
<b>Fund Balances - end of year</b>	<u>\$ 6,333,355</u>	<u>\$ 18,788,836</u>	<u>\$ 2,360,727</u>	<u>\$ 27,482,918</u>

See notes to the Financial Statements.

**HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1**

**RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES  
AND CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS  
TO THE STATEMENT OF ACTIVITIES**

**For the Year Ended June 30, 2016**

Net change in fund balances - total governmental funds: \$ 20,368,858

Amounts reported for Governmental Activities in the Statement of  
Activities are different because:

Governmental funds do not report revenues that are not available to pay  
current obligations. In contrast, such revenues are reported in the  
Statement of Activities when earned. The difference is for property taxes  
and related penalties and interest. 48,099

Governmental funds report capital outlays as expenditures. However, in the  
Statement of Activities the costs of those assets is allocated over their  
estimated useful lives and reported as depreciation expense for the period.

Capital outlay expenditures	\$ 1,457,400	
Depreciation expense	(205,553)	
		1,251,847
Change due to capital assets		

The issuance of long-term debt provides current financial resources to  
governmental funds, while the repayment of principal uses current financial  
resources. However, at the government-wide level these transactions have  
the effect of increasing or decreasing long-term liabilities.

Principal payment of debt	795,000	
Proceeds from issuance of debt	(20,365,000)	
Premium is amortized over the life of the bond	60,021	
Deferred charge on refunding is amortized over the life of the bond	(20,136)	
		(19,530,115)

Some expenses reported in the statement of activities do not require the use  
of current financial resources and are not reported as expenditures in  
governmental funds. These are as follows:

Change in compensated absences	25,604	
Change in interest payable	(158,245)	
		(132,641)
Change in net position of governmental activities		<u>\$ 2,006,048</u>

See notes to the Financial Statements.

# HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

## NOTES TO THE FINANCIAL STATEMENTS

June 30, 2016

### A. Summary of Significant Accounting Policies

The financial statements of Harris County Improvement District No. 1 (“the District”) have been prepared in conformity with generally accepted accounting principles (GAAP) as applied to governmental units. The Government Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and reporting principles. The following is a summary of the most significant policies.

#### Creation

Harris County Improvement District No. 1 (the “District”) was organized, created, and established pursuant to an act of the 70<sup>th</sup> Texas State Legislature, effective under the terms and provisions of Article III, Section 52 and Article XVI, Section 59 of the Texas Constitution. The Board of Directors held its organizational meeting on July 18, 1987. The first bonds were sold on June 23, 1993. See Note F for additional information regarding significant legal provisions contained in the legislative act creating the District.

The District's primary activities include managing and financing improvement projects and/or services benefiting the District. These activities include maintenance and beautification of the area, traffic control and transportation projects, special events for the holiday seasons, general planning and engineering, area marketing, major capital improvements and general and administrative services.

#### Reporting Entity

The District is a political subdivision of the State of Texas, governed by an appointed board, and is considered a primary government. The GASB has established the criteria for determining whether or not an entity is a primary government or a component unit of a primary government. The primary criteria are that it has a separately elected governing body; it is legally separate; and it is fiscally independent of other state and local governments. Under these criteria, the District is considered a primary government and is not a component unit of any other government. Additionally, no other entities meet the criteria for inclusion in the District’s financial statements as component units.

#### Government-wide and Fund Financial Statements

Government-wide financial statements display information about the District as a whole. These statements focus on the sustainability of the District as an entity and the change in aggregate financial position resulting from activities of the fiscal period. Interfund activity, if any, has been removed from these statements. The government wide statements consist of the *Statement of Net Position* and the *Statement of Activities*.

The *Statement of Activities* demonstrates the degree to which the direct expenses of a given function or segment is offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenue includes: (1) charges to customers or applicants, who purchase, use or directly benefit from goods, services, or privileges provided by a given function or segment and (2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular segment. Taxes and other items not properly included among program revenues are reported as general revenues.

## HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

### NOTES TO THE FINANCIAL STATEMENTS *(continued)*

#### A. Summary of Significant Accounting Policies - continued

Fund financial statements display information at the individual fund level. A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for a specific purpose. Each fund is considered to be a separate accounting entity. These fund financial statements are the *Governmental Funds- Balance Sheet* and the *Governmental Funds - Statement of Revenues, Expenditures and Changes in Fund Balances*

The District reports the following major governmental funds:

The *General Fund* is used to account for administrative operations of the District. The principal source of revenue is property taxes. Expenditures include all costs associated with the daily operations of the District.

The *Debt Service Fund* is used to account for the payment of interest and principal on all general long-term debt of the District. The primary source of revenue is provided by contract tax increment revenue.

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

#### Measurement Focus and Basis of Accounting

The Government-wide financial statements are reported using the *economic resources measurement focus* and the *accrual basis of accounting*. Revenues are recognized when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Governmental fund financial statements are reported using the *current financial resources measurement focus* and the *modified accrual basis of accounting*. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available if they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the District considers revenues to be available if they are collected within 60 days of the end of the current fiscal period; property taxes are recognized when collected. Expenditures are generally recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

#### Receivables

All receivables are reported at their gross value and, where appropriate, are reduced by the estimated portion that is expected to be uncollectible. At June 30, 2016, an allowance for uncollectible property tax accounts was not considered necessary.

#### Prepaid Items

Certain payments made by the District reflect costs applicable to future accounting periods and are recorded as prepaid items in both the government-wide and fund financial statements.

**HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1**

**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**A. Summary of Significant Accounting Policies - continued**

**Capital Assets**

Capital assets are reported in the government-wide financial statements. The District defines capital assets as assets with an initial, individual cost of \$5,000 or more and an estimated useful life in excess of one year. Capital assets are recorded at historical cost or estimated historical cost. Donated capital assets are recorded at the estimated fair value at the date of donation. Assets are depreciated over their remaining useful lives using the straight-line method.

Asset	Estimated Useful Lives
Machinery and Equipment	10 - 20 years

**Fund Balance / Restricted Assets**

The District records reservations for all or portions of governmental fund balances which are legally segregated for specific future use or which do not represent available spendable resources and therefore not available for appropriation. Unassigned fund balance indicates the portion of fund balance which is available for appropriation in future periods. The restricted fund balances for governmental funds represent the amount that has been identified for specific purposes.

The District applies restricted resources when an expense is incurred for purposes for which both restricted and unrestricted net position are available.

The following fund balance classifications describe the relative strength of the spending constraints:

*Nonspendable fund balance* – amounts that are not in spendable form or are required to be maintained intact. As such, the inventory and prepaid items have been properly classified in the Governmental Funds Balance Sheet.

*Restricted fund balance* – Amounts that can be spent only for specific purposes because of local, state or federal laws, or externally imposed conditions by grantors or creditors.

*Committed fund balance* – amounts constrained to specific purposes by the District itself, using its highest level of decision-making authority (i.e. the Board of Directors). To be reported as committed, amounts cannot be used for any other purposes unless the District takes the same highest level of action to remove or change the constraint.

*Assigned fund balance* – amounts the District intends to use for a specific purpose. Intent can be expressed by the Authority or by an official or body to which the Board of Directors delegates the authority. Funds maybe be assigned by the District’s president or by the Board of Directors for specific purposes through the budget process or agenda items.

*Unassigned fund balance* – amounts that are available for any purpose. Positive amounts are reported only in the general fund.

## HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

### NOTES TO THE FINANCIAL STATEMENTS (*continued*)

#### A. Summary of Significant Accounting Policies - continued

##### **Fund Balance / Restricted Assets - continued**

The District establishes (and modifies or rescinds) fund balance commitments by passage of a resolution. When an expenditure is incurred for purposes for which both restricted and unrestricted fund balance is available, the District considers restricted funds to have been spent first. When an expenditure is incurred for which committed, assigned, or unassigned fund balances are available, the District considers amounts to have been spent first out of committed funds, then assigned funds, and finally unassigned funds. The District has nonspendable, restricted and unassigned fund balances as of June 30, 2016.

##### **Deferred Outflows/Inflows of Resources**

In addition to assets, the statement of financial position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, *deferred outflows of resources*, represents a consumption of net position that applies to a future period(s) and so will *not* be recognized as an outflow of resources (expense/ expenditure) until then. The District only has one item that qualifies for reporting in this category. It is the deferred charge on refunding reported in the government-wide statement of net position. A deferred charge on refunding results from the difference in the carrying value of refunded debt and its reacquisition price. This amount is deferred and amortized over the shorter of the life of the refunded or refunding debt. At year-end, the District had a deferred outflow of \$144,478.

In addition to liabilities, the governmental funds balance sheet will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, *deferred inflows of resources*, represents an acquisition of fund balance that applies to a future period(s) and so will *not* be recognized as an inflow of resources (revenue) until that time. The District has unavailable property taxes including penalty and interest of \$181,772 that qualifies for reporting in this category, which arise only under a modified accrual basis of accounting.

##### **Interfund Activity**

During the course of operations, transactions occur between individual funds. This can include internal transfers, payables and receivables. This activity is combined as internal balances and is eliminated in both the government-wide and fund financial statements.

##### **Compensated Absences**

The District's employees earn vacation leave, which may either be taken or accumulated, up to certain amounts, until paid upon termination or retirement. The amounts are recorded as a liability in the *Statement of Net position*.

##### **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 amounts reported in the financial statements. Actual results could differ from those estimates.

**HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1**

**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**A. Summary of Significant Accounting Policies - continued**

**New Accounting Standards**

In the current fiscal year, the District implemented the following new standards. The applicable provisions of these new standards are summarized below. Implementation is reflected in the financial statements and the notes to the financial statements.

GASB Statement No. 72, Fair Value Measurement and Application, addresses accounting and financial reporting issues related to fair value measurements. The definition of fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This Statement provides guidance for determining a fair value measurement for financial reporting purposes. This Statement also provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements.

**B. Deposits and Investments**

As of June 30, 2016, the District's cash was comprised of the following:

	<u>Carrying Value</u>	<u>Bank Balance</u>
Money market funds	\$ 27,559,888	\$ 29,013,699
Restricted Cash	107,996	107,996
	<u>\$ 27,667,884</u>	<u>\$ 29,121,695</u>

The cash deposits were entirely covered by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000 or by pledged collateral held by the District's agent banks in the District's name.

As of June 30, 2016, the District had no investments.

**Authorized Investments**

The District is authorized by the *Public Funds Investment Act* (Chapter 2256, Texas Government Code) 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) other obligations, which are unconditionally guaranteed or insured by the State of Texas or the United States or its agencies or instrumentalities, (5) certain A rated or higher obligations of states and political subdivisions of any state, (6) bonds issued, assumed or guaranteed by the State of Israel, (7) insured or collateralized certificates of deposit, (8) certain fully collateralized repurchase agreements, (9) bankers' acceptances with limitations, (10) commercial paper rated A-1 or P-1 or higher and a maturity of 270 days or less, (11) no-load money market mutual funds and no-load mutual funds, with limitations, (12) certain guaranteed investment contracts, (13) certain qualified governmental investment pools and (14) a qualified securities lending program.

The District has adopted a written investment policy to establish the principles by which the District's investment program should be managed. This policy further restricts the types of investments in which the District may invest.

**HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1**

**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**B. Deposits and Investments - continued**

**Investment Credit and Interest Rate Risk**

Investment credit risk is the risk that the investor may not recover the value of an investment from the issuer, while interest rate risk is the risk that the value of an investment will be adversely affected by changes in interest rates. The Authority's investment policies do not address investment credit and interest rate risk beyond the rating and maturity restrictions established by state statutes.

**Restricted Cash**

As discussed in Note I, the District has entered into an agreement for deferred compensation for certain employees, the amount in the plan's account is restricted for additional compensation to certain employees after their retirement, or a death benefit to the employees' designated beneficiaries after their deaths.

**C. Capital Assets**

A summary of changes in capital assets, for the year ended June 30, 2016, follows:

	<b>Restated Beginning Balance</b>	<b>Additions</b>	<b>Retirements and Transfers</b>	<b>Ending Balance</b>
Capital assets, not being depreciated				
Construction in progress	\$ -	\$ 1,457,400	\$ -	\$ 1,457,400
Total Capital assets, not being depreciated	-	1,457,400	-	1,457,400
Capital assets, being depreciated:				
Machinery and equipment	16,052,719	-	-	16,052,719
Less accumulated depreciation	(13,638,284)	(205,553)	-	(13,843,837)
Total Capital assets, net of depreciation	2,414,435	(205,553)	-	2,208,882
<b>Governmental Capital Assets</b>	<b>\$ 2,414,435</b>	<b>\$ 1,251,847</b>	<b>\$ -</b>	<b>\$ 3,666,282</b>

Depreciation was charged to functions of the District as follows:

Traffic control	\$ 203,053
Marketing and communication	2,500
Total depreciation expense	<u>\$ 205,553</u>

**HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1**

**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**D. Long-Term Liabilities**

During the year, the District's long-term liabilities changed as outlined below:

	<b>Beginning Balance</b>	<b>Additions</b>	<b>Reductions</b>	<b>Ending Balance</b>	<b>Due Within One Year</b>
Bonds payable	\$ 8,505,000	\$ 20,365,000	\$ (795,000)	\$ 28,075,000	\$ 2,165,000
Unamortized premiums	490,691	-	(60,021)	430,670	-
Compensated absences	98,000	120,811	(146,415)	72,396	24,132
	<u>\$ 9,093,691</u>	<u>\$ 20,485,811</u>	<u>\$ (1,001,436)</u>	<u>\$ 28,578,066</u>	<u>\$ 2,189,132</u>

Bonds payable as of June 30, 2016 consists of the following:

<b>Series</b>	<b>Amount Outstanding</b>	<b>Original Issue</b>	<b>Interest Rate</b>
Refunding Bonds, Series 2013	\$ 7,710,000	\$ 9,300,000	1.875%-4.00%
Improvement Bonds, Series 2015	20,365,000	20,365,000	2.499%
<b>Total</b>	<u>\$ 28,075,000</u>		

On December 22, 2015, the District issued \$20,365,000 Tax Increment Contract Revenue Bonds, Series 2015. The bonds have an interest rate of 2.499 percent. The bonds will be used (1) for the stimulation and development of transportation and (2) to pay the costs associated with the issuance of the Bonds. The Bonds mature September 1, 2030.

During the fiscal year ended June 30, 2013, the District issued 2013 Refunding Bonds, refunding a portion of the 1999 and the 2004 bond issues. The reacquisition price exceeded the net carrying amount of the old debt by \$204,886. This resulting deferred outflow is amortized over the life of the Bond.

	<b>Previous Balance</b>	<b>Current Year</b>	<b>Year End Balance</b>
Refunding difference 2013 Issue	\$ 164,614	\$ (20,136)	\$ 144,478
	<u>\$ 164,614</u>	<u>\$ (20,136)</u>	<u>\$ 144,478</u>

Payment of principal and interest on the bonds is to be provided from tax levies on properties within the District. As the bonds are unlimited tax bonds, no other funds of the District have been pledged for debt service requirements. Investment income realized by the Debt Service Fund, from investment of excess funds, will be used to pay outstanding bond principal and interest. The District is in compliance with all significant requirements and restrictions contained in its bond resolution.

**HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1**

**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**D. Long-Term Liabilities - continued**

Annual debt service requirements to retire these outstanding bonds are as follows:

<u>Year Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2017	\$ 2,165,000	\$ 721,117	\$ 2,886,117
2018	2,090,000	663,354	2,753,354
2019	2,140,000	606,940	2,746,940
2020	2,200,000	548,040	2,748,040
2021	2,265,000	487,391	2,752,391
2022	2,320,000	425,066	2,745,066
2023	2,345,000	361,604	2,706,604
2024	2,385,000	291,855	2,676,855
2025	1,350,000	237,155	1,587,155
2026	1,380,000	203,043	1,583,043
2027	1,415,000	168,120	1,583,120
2028	1,450,000	132,322	1,582,322
2029	1,485,000	95,649	1,580,649
2030	1,525,000	58,039	1,583,039
2031	1,560,000	19,492	1,579,492
	<u>\$ 28,075,000</u>	<u>\$ 5,019,187</u>	<u>\$ 33,094,187</u>

A summary of District Bonds authorized, but unissued at June 30, 2016 follows:

<u>Purpose</u>	<u>Date Authorized</u>	<u>Amount Authorized</u>	<u>Amount Unissued</u>
Stimulation and development of transportation	05/30/92	\$ 75,000,000	\$ 39,530,000
Conservation and preservation of natural resources	05/30/92	25,000,000	21,995,000
Improvement projects payable from assessments	05/30/92	25,000,000	25,000,000
Improvement projects for economic diversification	11/20/93	25,000,000	25,000,000
		<u>\$ 150,000,000</u>	<u>\$ 111,525,000</u>

**E. Property Taxes**

On May 30, 1992, the voters of the District authorized the District's Board of Directors to levy taxes annually for use in financing general operations (maintenance tax) limited to \$0.25 per \$100 of assessed property valuation. The Harris County Appraisal District determines all property valuations and exempt status, if any. The District's bond resolution requires that property taxes be levied for use in paying interest and principal on long-term debt and for use in paying costs incurred in assessment and collection of these taxes. Taxes levied for debt service and related costs are without limitation as to rate or amount.

The District has contracted with the Harris County Tax Assessor/Collector for its tax levy and collection functions. A tax lien attaches to properties within the District on January 1 of each year when property valuations for use in levying taxes are established. Taxes levied are generally billed in October and are due upon receipt of the tax bill. Penalty and interest are charged if taxes are not paid by January 31. There is an additional 15% penalty charged on accounts delinquent after July 1, which generally is payable to the District's delinquent tax attorney.

**HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1**

**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**E. Property Taxes - continued**

Property taxes are collected based on rates adopted in the year of the levy. The District's fiscal year ended June 30, 2016, was financed through the 2015 tax levy. The District levied property taxes of \$0.14345 per \$100 of assessed value, of which \$0.10145 was allocated to maintenance and operations and \$0.04200 was allocated to debt service. The resulting tax levy was on the adjusted taxable value of \$5,657,041,108.

Taxes receivable, at June 30, 2016, consisted of the following:

Current year taxes receivable	\$	60,127
Delinquent taxes receivable		61,481
		<u>121,608</u>
Penalty and interest receivable		60,164
Total property taxes receivable	\$	<u><u>181,772</u></u>

**F. Significant Legal Provisions of Legislative Act Creating District**

As discussed in Note A above, the District has been established pursuant to an act of the Texas State Legislature. Significant legal provisions of this act are summarized below.

**District Boundaries**

The Act provides specifically for boundaries of the District, which includes the Uptown Houston area. The Uptown Houston area is also known as the Galleria-Post Oak area in Houston, Texas. The District may annex additional land area in accordance with Chapter 54 of the Texas Water Code. On May 22, 2013, Harris County Improvement District No. 1 adopted an Order Adding Land (responding to a petition of the landowners) adding 33.99 acres of land (located in the vicinity of the intersection of US 59 and IH 610) to the District.

**Texas Commission on Environmental Quality Involvement**

The Act provides that the Texas Commission on Environmental Quality is to appoint District Directors. The Directors are to serve staggered four-year terms. Additionally, the Texas Commission on Environmental Quality must approve the issuance of any bonded indebtedness for the purposes of providing water, sewer or drainage facilities within the District. No other District activities are subject to the jurisdiction of the Texas Commission on Environmental Quality.

**General and Specific Powers of the District**

The Act provides general powers to the District subject to general laws and regulations of the state applicable to conservation and reclamation districts created under Article XVI, Section 59 of the Texas Constitution and road districts and road utility districts created pursuant to Article III, Section 52, of the Texas Constitution, including those conferred by Chapter 54 of the Water Code and Chapter 13, Acts of the 68th legislature, 2nd Called Session, 1984 (Article 6674r-1, Vernon's Texas Civil Statutes).

## **HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1**

### **NOTES TO THE FINANCIAL STATEMENTS (continued)**

#### **F. Significant Legal Provisions of Legislative Act Creating District - continued**

##### **General and Specific Powers of the District - continued**

Additional specific powers and duties are provided for in the act, which include the financing of improvement projects and/or services for the benefit of the District. Specific types of improvement projects are provided for in the act and include the acquisition of land in connection with the improvements. Eminent domain powers are specifically prohibited by the act. Improvement projects and/or services may be financed in whole or in part by the levy and collection of special assessments or property taxes on property in the area. The act also provides that maintenance taxes may be levied after voter approval.

The Act provides for the method by which the District must petition, provide notice and hold public hearings prior to the financing of the improvement projects and/or services.

The Act also provides for the issuance of voter-approved bonded indebtedness to finance improvement projects and/or services. Specific guidelines in the act provide for the repayment of bonds, which might be issued, as well as the use of bond proceeds, available security that can be pledged in issuing the bonds and refunding capabilities for outstanding bonds.

##### **Director Bonds**

The Act requires that each Director appointed execute a bond for \$10,000 payable to the District and conditioned on faithful performance of his or her duties. All bonds of the Directors shall be approved by the Board.

#### **G. Operating Agreement - Uptown Development Authority**

The District has entered into an operating agreement with Uptown Development Authority (the "Authority"). The Authority is a component unit of the City of Houston formed to carry on improvements in the Uptown Houston area. The governing boards of both the District and the Authority have common members. It is the intent of both governing boards to maintain separately controlled operating entities. The agreement calls for the District to perform services as and when requested by the Authority Board. The services may consist of general administrative support, project management and development, consultant management, and other services as may be deemed necessary. The District is the recipient of federal grants for pedestrian and intersection improvements within the District. Additionally, the Authority has an approved capital improvement plan which includes pedestrian and intersection improvements. These two entities will work in conjunction with the Authority providing the local match and the implementation of the project while the District will provide the grant funds (see Note N). Financial information regarding the Authority can be obtained from Uptown Development Authority, 1980 Post Oak Boulevard #1700, Houston, Texas 77056.

##### **Financing Agreement - Uptown Development Authority**

The District has a Finance Agreement with the Uptown Development Authority (The UDA) in which the Authority could borrow up to \$3.5 million, which is to be repaid by the Authority's fiscal year-end (June 30, 2016). While this agreement is still in place, the Authority did not make use of requesting funds from the District. This agreement is reviewed and approved annually by both Boards of Directors.

## **HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1**

### **NOTES TO THE FINANCIAL STATEMENTS (continued)**

#### **H. Pension Plan**

For the benefit of its employees, the District provides discretionary contributions to a simplified employee pension plan, meeting the requirements of Internal Revenue Code Section 408(k). For the year ended June 30, 2016, the District contributed \$148,500 to the plan.

#### **I. Deferred Compensation**

During the fiscal year ended June 30, 2016, the district entered into a Retirement Plan governed by the provisions of Section 457(f) of the Internal Revenue Code of 1986, as amended. Each year, the District's Board determines the contribution to be made for additional compensation to certain eligible employees after their retirement, or a death benefit to the employees' designated beneficiaries after their deaths. The amount in the Retirement Plan as of June 30, 2016 is \$107,996.

#### **J. Risk Management**

The District is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; and personal injuries. The risk of loss is covered by commercial insurance. There have been no significant reductions in insurance coverage. Settlement amounts have not exceeded insurance coverage for current year or the three prior years.

#### **K. Budget Overages**

The Schedule of Revenues, Expenditures and Changes in Fund Balances – Budget to Actual presents budget overages in certain expenditures. General and Administrative expenditures exceeded the budget due to incurred costs associated with special counsel to the Board on real estate transactions, costs for local intergovernmental relations and costs for legal assistance regarding numerous open records requests. These costs were incurred due to the Post Oak Boulevard infrastructure project. Overall the District operated with a positive budget variance.

#### **L. Tax Increment Reinvestment Zone**

During the current and prior years, the District incurred certain planning expenditures related to the Tax Increment Reinvestment Zone No. 16 of the City of Houston (TIRZ). The TIRZ is located on property generally within the District's service area. During the year ended June 30, 2016, the District received \$1,573,264 from the TIRZ for reimbursement of administration costs, project management costs and traffic and mobility costs.

**HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1**

**NOTES TO THE FINANCIAL STATEMENTS (continued)**

**M. Federal Grants**

The District is a recipient of a federal grant for pedestrian and intersection improvements: Congestion Mitigation and Air Quality (CMAQ) 80/20 Grant and a Congressional appropriated Discretionary Grant. In accordance with the operating agreement with the Uptown Development Authority (UDA); the grant funds are used to fund the UDA’s capital improvement plan. The UDA expends all funds for purposes of the grant, including a 20% local matching requirement under the CMAQ grant terms. All grant revenues are recognized by the District based on the UDA spending and are then paid to the UDA as a reimbursement for grant related spending.

A summary of grant activity through June 30, 2016, is shown below along with similar information for the total grant.

<u>Funding Source</u>	<u>Cumulative Amounts</u>	
	<u>Actual through June 30, 2016</u>	<u>Total Grant Awarded</u>
Congestion Mitigation Air Quality Federal (CMAQ) Grant (80%)	\$ 17,800,320	\$ 26,920,962
Congressional Appropriated Discretionary Grant	2,464,244	2,665,864
	<u>\$ 20,264,564</u>	<u>\$ 29,586,826</u>

The CMAQ and the Discretionary Grant both require a 20 percent match, which is made by the UDA. For the cumulative period ending June 30, 2016, the UDA provided the required local match of \$498,395.

**N. Related Party Transactions**

***Mizington Incorporated***

Harris County Improvement District #1 (HCID #1) has a service agreement with Mizington Incorporated for professional services. The Mizington employees are former HCID #1 employees. Mizington was created to provide employees with the option to contribute to social security as HCID #1 employees do not.

***Uptown Development Authority***

The District has entered into an operating agreement with Uptown Development Authority (the “Authority”). It is the intent of both governing boards to maintain separately controlled operating entities. There are two members of the District board that also serve on the Authority board. The agreement calls for the District to perform services as and when requested by the Authority Board. The services may consist of general administrative support, project management and development, consultant management, and other services as may be deemed necessary.

The Authority has an approved capital improvement plan which includes the reconstruction of Post Oak Boulevard. This Authority project requires the purchase of rights-of-way along Post Oak Boulevard. While the Authority is the purchaser, there are some parcels along the Boulevard that are owned and/or affiliated by/with members of the District board.

## HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

### NOTES TO THE FINANCIAL STATEMENTS *(continued)*

#### **N. Related Party Transactions - continued**

As public agencies, the District and the Authority are governed by strict laws and regulations on how property is acquired for public projects.

As of the June 30, 2016, reporting period, the Authority purchased a parcel of land from WMJK, Ltd. The Authority Director and District Chairman is an owner in this property. The Director filed an affidavit and recused himself from the Board vote. Subsequent to the June 30, 2016 reporting period, the Authority purchased an additional Post Oak Boulevard parcel from a District Director. The Authority has chosen to keep the purchase prices for property acquired along Post Oak Boulevard confidential until the Authority closes each parcel, this information is excepted from disclosure under 552.105 of the Texas Government Code. Total cost of acquisition is available upon request.

#### **O. Prior period adjustment**

During prior years the general fund made a payment for design invoices expecting reimbursement from the capital projects fund, however upon review it was determined that the capital project would not pay back the general fund. A prior period adjustment is necessary for the governmental funds. This prior period adjustment decreased fund balance in the general fund by \$351,815 and increased fund balance in the capital projects fund by the same amount. This prior period adjustment has no effect in the statement of net position for the governmental activities.

In addition, depreciation expense was overstated in prior years, as such a prior period adjustment was recorded during the current year to increase net position for the governmental activities by \$614,179. This prior period adjustment has no effect in the governmental funds' fund balance.

#### **P. Subsequent event**

In August 2016, the District authorized the issuance of \$8,150,000 Unlimited Tax Bonds, Series 2016.

**REQUIRED SUPPLEMENTARY INFORMATION**

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**HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1**

**SCHEDULE OF REVENUES, EXPENDITURES AND CHANGES  
IN FUND BALANCES - BUDGET TO ACTUAL**

**June 30, 2016**

	<b>Original Budget</b>	<b>Final Budget</b>	<b>Actual</b>	<b>Variance with Final Budget Positive/ (Negative)</b>
<b>Revenues</b>				
Property taxes	\$ 5,693,022	\$ 5,693,022	\$ 5,447,948	\$ (245,074)
Intergovernmental	1,544,800	1,544,800	1,540,001	(4,799)
Shelter program (Metro)	33,263	33,263	33,263	-
Investment earnings	12,460	12,460	15,708	3,248
HGAC Grants	4,346,500	4,346,500	1,275,311	(3,071,189)
Miscellaneous	-	-	666,744	666,744
<b>Total Revenues</b>	<b>11,630,045</b>	<b>11,630,045</b>	<b>8,978,975</b>	<b>(2,651,070)</b>
<b>Expenditures</b>				
<b>Current:</b>				
Planning and engineering	85,000	85,000	60,953	24,047
Traffic control	1,329,585	1,329,585	1,127,139	202,446
Maintenance and beautification	1,866,970	1,866,970	1,853,561	13,409
General and administrative	2,962,500	2,962,500	3,144,262	(181,762)
Marketing and communications	910,000	910,000	850,583	59,417
Economic development	96,000	96,000	67,949	28,051
Transfer of HGAC Grants to UDA	4,346,500	4,346,500	1,275,311	3,071,189
<b>Total Expenditures</b>	<b>11,596,555</b>	<b>11,596,555</b>	<b>8,379,758</b>	<b>3,216,797</b>
<b>Excess (deficiency) of revenues over expenditures</b>	<b>33,490</b>	<b>33,490</b>	<b>599,217</b>	<b>(565,727)</b>
<b>Other Financing Sources (Uses)</b>				
Transfers out	-	-	(82,033)	(82,033)
<b>Total Other Financing Sources (uses)</b>	<b>-</b>	<b>-</b>	<b>(82,033)</b>	<b>(82,033)</b>
<b>Net change in fund balance</b>	<b>33,490</b>	<b>33,490</b>	<b>517,184</b>	<b>483,694</b>
Fund balance - beginning of year	6,167,986	6,167,986	6,167,986	-
Prior period adjustment	-	-	(351,815)	(351,815)
<b>Fund balance - end of year</b>	<b>\$ 6,201,476</b>	<b>\$ 6,201,476</b>	<b>\$ 6,333,355</b>	<b>\$ 131,879</b>

**HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1**

**NOTES TO REQUIRED SUPPLEMENTARY INFORMATION**

**June 30, 2016**

**Budgets and Budgetary Accounting**

A non-appropriated budget is adopted for the General Fund by the District's Board of Directors. The budget is considered a planning tool and does not constitute legal spending limit authority. The budget is prepared using the same method of accounting as for the financial reporting except that the General Fund budget includes federal grant revenues and the related transfers. For financial reporting purposes, the federal grant revenues (included in HGAC grants in the preceding schedule) and the related transfers to UDA are reported in the Capital Projects Fund as an intergovernmental revenue and as an expenditure, respectively.

Prior to July 1, 2015, the District adopted its annual budget, or Original Budget, any amendments to the budget are made throughout the year but prior to June 30, 2016 to present a Final Budget as of June 30, 2016. There were no amendments to the budget during the fiscal year.

**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON  
COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL  
STATEMENTS PERFORMED IN ACCORDANCE WITH  
GOVERNMENT AUDITING STANDARDS**

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

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of the governmental activities and each major fund of Harris County Improvement District No. 1's (the "District") as of and for the year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the District's basic financial statements, and have issued our report thereon dated December 6, 2016.

**Internal Control over Financial Reporting**

In planning and performing our audit of the financial statements, we considered the District's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control. Accordingly, we do not express an opinion on the effectiveness of the District's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

To the Board of Directors  
Harris County Improvement District No. 1

### **Compliance and Other Matters**

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

### **Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the District's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

A handwritten signature in black ink that reads "Whitley Penn LLP". The signature is written in a cursive, flowing style.

Houston, Texas  
December 6, 2016

**REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM AND  
REPORT ON INTERNAL CONTROL OVER COMPLIANCE REQUIRED  
BY THE *UNIFORM GUIDANCE***

To the Board of Trustees  
Harris County Improvement District No. 1  
Houston, Texas

**Report on Compliance for Each Major Federal Program**

We have audited Harris County Improvement District No. 1's (the "District") compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of the District's major federal programs for the year ended June 30, 2016. The District's major federal program is identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

**Management's Responsibility**

Management is responsible for compliance with the federal statutes, regulations, and the terms and conditions of its federal awards applicable to its federal programs.

**Auditor's Responsibility**

Our responsibility is to express an opinion on compliance for each of the District's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the District's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of the District's compliance.

**Opinion on Each Major Federal Program**

In our opinion, Harris County Improvement District No. 1 complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on its major federal program for the year ended June 30, 2016.

To the Board of Directors  
Harris County Improvement District No. 1

### **Report on Internal Control Over Compliance**

Management of the District is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the District's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the District's internal control over compliance.

*A deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. *A significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.



Houston, Texas  
December 6, 2016

**HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**FOR THE YEAR ENDED JUNE 30, 2016**

**I. Summary of Auditors' Results**

**Financial Statements**

Type of auditors' report issued	Unmodified
Internal control over financial reporting:	
Material weakness (es) identified?	No
Significant deficiency (ies) identified that are not considered to be material weaknesses?	None reported
Noncompliance material to the financial statements noted?	No

**Federal Awards**

Internal controls over major programs:	
Material weakness (es) identified?	No
Significant deficiency (ies) identified that are not considered to be material weaknesses?	None reported
Type of auditor's report issued on compliance for major programs:	Unmodified
Any audit findings disclosed that are required to be reported in accordance with 2 CFR 200.516(a)?	None

Identification of Major Programs:

<b>Name of Federal Program</b>	<b>CFDA Number</b>
<b>Federal Transit Cluster:</b>	
Federal Transit – Formula Grants	20.507
Dollar Threshold Considered Between Type A and Type B Federal Programs	\$750,000
Auditee qualified as low-risk auditee?	Yes

**HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS *(continued)*  
FOR THE YEAR ENDED JUNE 30, 2016**

**II. Financial Statement Findings**

No current year findings.

**III. Federal Award Findings and Questioned Costs**

No current year findings.

**IV. Summary Schedule of Prior Audit Findings**

No prior year findings.

**HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1**

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE YEAR ENDED JUNE 30, 2016**

<u>Federal Grantor/ Pass Through Grantor/ Program Title</u>	<u>CFDA Number</u>	<u>Grantor Number</u>	<u>Federal Grant Expenditures</u>
<b>Department of Transportation</b>			
<b>Direct:</b>			
<b><u>Federal Transit Cluster:</u></b>			
<i>Federal Transit Formula Grants:</i>			
<i>Pedestrian/Transit Improvement Program</i>	20.507	TX-95-X005-03	\$ 218,288
<i>Post Oak Dedicated Bus Lanes/Trst Ctr</i>	20.507	TX-95-X077-00	<u>1,057,023</u>
<b>Total Federal Transit Cluster</b>			<u>1,275,311</u>
<b>Total Department of Transportation</b>			<u>1,275,311</u>
<b>Total Federal Awards</b>			<u><u>\$ 1,275,311</u></u>

## HARRIS COUNTY IMPROVEMENT DISTRICT NO. 1

### NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

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

The District accounts for federal funding using the modified accrual method of accounting. This basis of accounting recognizes revenues in the accounting period in which they become susceptible to accrual, i.e. both measurable and available, and expenditures in the accounting period in which the liability is incurred, if measurable, except for compensated absences, claims and judgments which are recognized when the obligations are expected to be liquidated with expendable available financial resources. Capital items for grant purposes are treated as expenses in the schedule of expenditures of federal awards.

Federal grant funds are considered to be earned to the extent of expenditures made under the provisions of the grant, and, accordingly, when such funds are received, they are recorded as unearned revenues until earned. Generally, unused balances are returned to the grantor at the close of specified project periods. The District has elected not to use the 10-percent de minimis indirect cost rate allowed under the Uniform Guidance

#### **Note 2 - Basis of Presentation**

The accompanying schedule of expenditures of federal awards (the "Schedule") includes the federal grant activity of the District under programs of the federal government for the year ended June 30, 2016. The information in this schedule is presented in accordance with the requirements of the Title 2 U.S. *Code of Federal Regulations Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Because the schedule presents only a selected portion of the operations of the District, it is not intended to and does not present the financial position, changes in net positions or cash flows of the District.