

OFFICE OF THE CITY CONTROLLER 100 YEARS OF HOUSTON HISTORY



CITY OF HOUSTON, TEXAS

Comprehensive Annual Financial Report for the fiscal year ended June 30, 2003

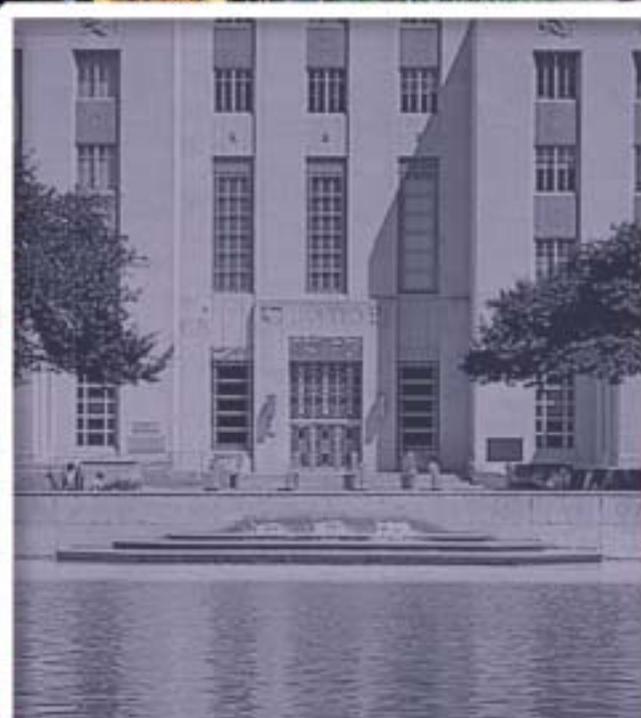
Prepared by:

Judy Gray Johnson, CPA, City Controller

Mary Ann Grant, Deputy City Controller, Financial and Technical Services Division



Houston's strength is its diversity



**CITY OF HOUSTON, TEXAS
 COMPREHENSIVE ANNUAL FINANCIAL REPORT
 For the Year Ended June 30, 2003**

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CITY OF HOUSTON, TEXAS





Office of the City Controller

Houston's City Controller, Judy Gray Johnson, is the second highest elected official in Houston City Government and its Chief Financial Officer, as dictated by the City Charter. The Office superintends the fiscal affairs of the City, which includes conducting audits, managing its investments and debt, preparing financial statements and providing leadership on policy issues pertaining to the City's financial health. She thus serves as an independently elected "financial watchdog" on issues of importance to the City. Fiscal year 2003 marked the 100th anniversary of the creation of the office.

Johnson was appointed City Controller in December 2002 to fill the last year of former City Controller Sylvia Garcia's unexpired term. Garcia vacated the city post upon her election as the Harris County Commissioner for Precinct 2. In addition to continuing to improve audit services, customer service, financial reporting, investment management, and technology, Johnson implemented a major office restructuring. One entire layer of management was eliminated, the number of divisions was reduced from seven to five, supervisors have taken on additional responsibilities, office publications have been eliminated, and subscriptions have been cut significantly. The result is a 6% decline in the Controller's Office budget.

In fiscal year 2003, the City Controller was called upon repeatedly as an economic resource for City Government and the city as a whole, providing analysis of revenue trends and guidance on debt practices. In addition, the Controller played an important role in increasing the balance in the Rainy Day Fund, ensuring the City will have cash on hand to respond to any unforeseen emergency. These actions strengthened the Office's image as a credible, fiscally prudent operation.

The Audit Division completed 25 audits in FY 2003. Among the audits was a database analysis of delinquent property taxes, traffic fines, and parking violations. This review identified approximately 5800 city vendors that owed \$23.7 million in delinquent taxes to the City of Houston and other local taxing jurisdictions. Another audit offered numerous recommendations to enhance the recovery of repair and maintenance costs for damages to the City's infrastructure caused by outside parties.

The Treasury Division's management of the City of Houston General Investment Pool was recognized in FY 2003 when the pool received the highest rating possible from Standard and Poor's Investment Services. The 'AAAf' credit quality rating reflects the extremely strong protection that the Pool's Portfolio Investments provide against losses from credit defaults or credit deterioration. The Pool was also awarded a 'S1' volatility rating in recognition of its low sensitivity to changing market conditions and conservative investment policies.

The FY 2003 Comprehensive Annual Financial Report (CAFR) is the second to reflect the new reporting model required by the Governmental Accounting Standards Board in its Statement 34. The inclusion of the new city-wide financial statements on the full accrual basis including infrastructure assets and depreciation in addition to individual governmental fund statements presented on the modified accrual basis is helping to provide more useful information to CAFR readers.

The preparation of the CAFR requires a concentrated effort by every division of the City Controller's Office. The Financial and Technical Services Division is ultimately responsible for the final product. The CAFR will be available on the City Controller's website, found at www.cityofhouston.gov/electedofficials/citycontroller.html.



JUDY GRAY JOHNSON

HOUSTON CITY CONTROLLER



Houston City Controller Judy Gray Johnson is a Certified Public Accountant with over 21 years of experience in the areas of accounting, auditing, management, and budgeting in both local government and private industry.

Ms. Johnson was appointed to fill the unexpired term of elected City Controller Sylvia Garcia. For the five years prior to her appointment, Ms. Johnson served as Chief Deputy City Controller, a position second-in-command to Ms. Garcia. Controller Johnson chose to leave the Chief Deputy City Controller's position vacant. As a result, she is fulfilling the duties of both the Controller and Chief Deputy Controller, overseeing the City's \$3 billion investment portfolio, nearly \$10 billion in debt and all aspects of financial reporting, disbursements, computer systems and auditing functions within the Controller's Office. She is the second highest City Officeholder.

Ms. Johnson's service to the City of Houston began in 1980 when she was appointed Deputy City Controller under former City Controller, Kathryn Whitmire. She also served as Deputy Director and Assistant Director of the City of Houston's Department of Finance and Administration.

In private industry, Ms. Johnson served as Tax Manager of the firm Miller, Wachman and Company in Boston, Massachusetts; Controller of Dueck Developments in Aurora, Colorado; and Tax Manager of Coopers and Lybrand in Houston.

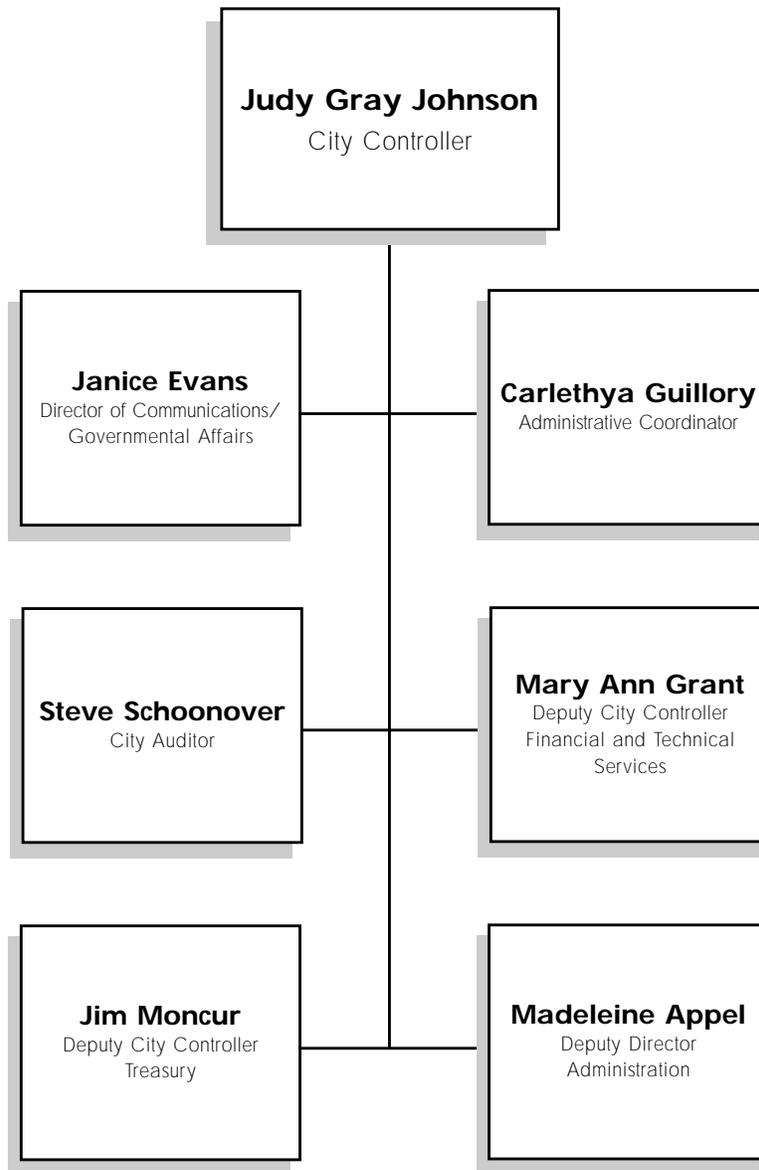
Controller Johnson received a Bachelor of Business Administration in Accounting from the University of Houston. She is a member of the American Institute of Certified Public Accountants; the Texas Society of Certified Public Accountants; and the American Woman's Society of Certified Public Accountants. Controller Johnson serves as chairwoman of the Government Accounting and Auditing Committee of the Houston Society of Certified Public Accountants. She was recently chosen as a "2003 Woman of Excellence." The honor bestowed by the Federation of Houston Professional Women recognizes the careers, community involvement, and education of outstanding women in the Greater Houston area.

Ms. Johnson was born in El Paso, Texas and raised in Albuquerque, New Mexico. She is married and has two teenage children. She and her family also spent four years in Norway in the mid-1990s.



City of Houston

The Office of the City Controller





Elected Officials City of Houston, Texas



Mayor

Lee P. Brown

City Controller

Judy Gray Johnson

Council Members

Gordon Quan, **Mayor Pro-Tem, Position 2**

Bert Keller, **Vice Mayor Pro-Tem, District G**

Annise Parker, **Position 1** Shelley Sekula-Gibbs, MD, **Position 3**

Michael Berry, **Position 4** Carroll G. Robinson, **Position 5**

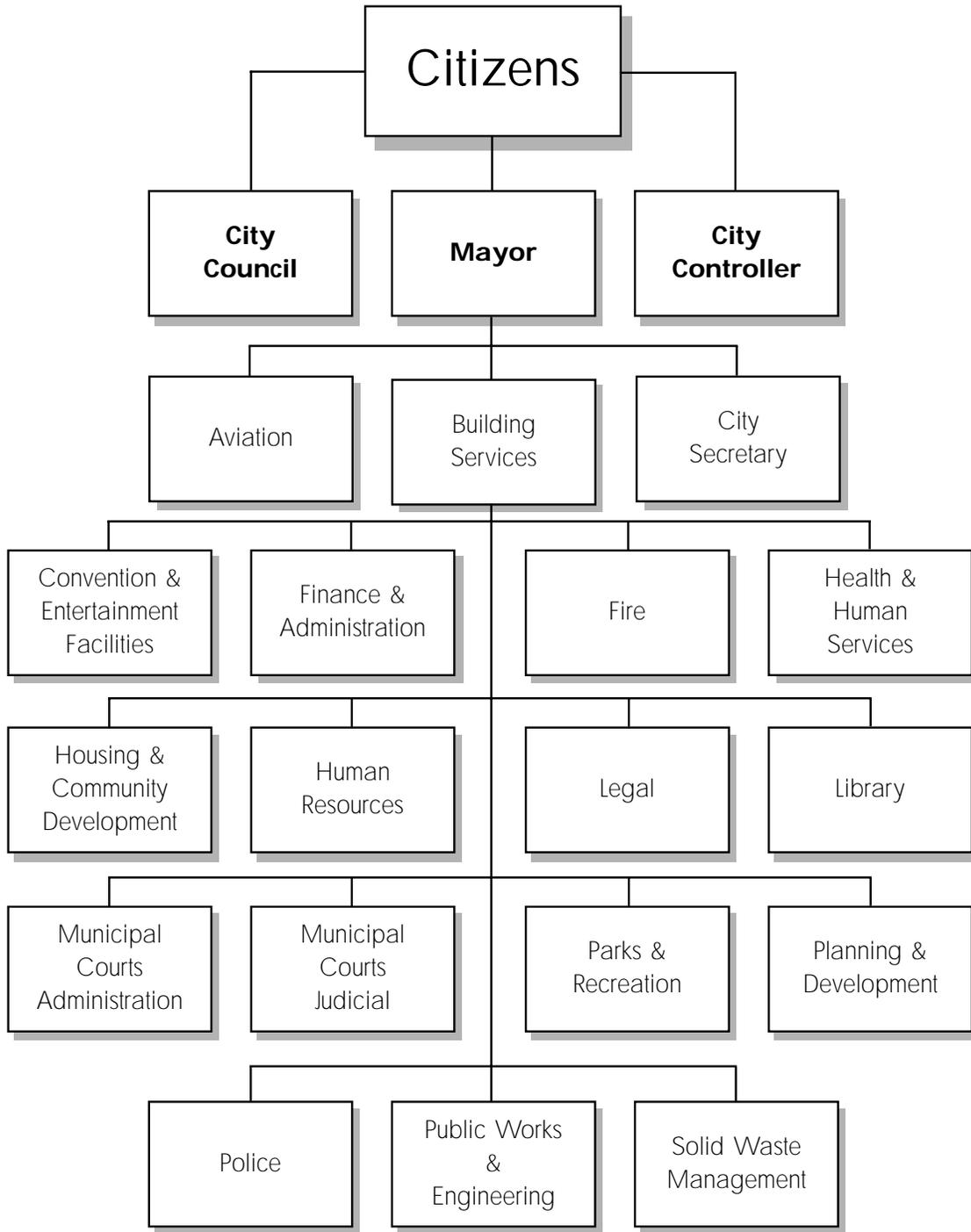
Bruce Tatro, **District A** Carol Galloway, **District B** Mark Goldberg, **District C**

Ada Edwards, **District D** Addie Wiseman, **District E** Mark Ellis, **District F**

Gabriel Vasquez, **District H** Carol Alvarado, **District I**



Organization Chart City Government



CITY OF HOUSTON, TEXAS





OFFICE OF THE CITY CONTROLLER
CITY OF HOUSTON
TEXAS

December 23, 2003

Honorable Mayor and City Council Members
Houston, Texas:

I am pleased to provide you with the Comprehensive Annual Financial Report (CAFR) of the City of Houston, Texas (City) for the year ended June 30th, 2003, including the independent auditor's report. The CAFR was prepared by the City Controller's Office and satisfies my responsibilities under state law. Responsibility for both the accuracy of the presented data and the completeness and fairness of the presentation, including all disclosures, rests with the City. To the best of our knowledge and belief, the enclosed data is accurate in all material respects, and is organized in a manner designed to fairly present the financial position and results of operations of the City as measured by the financial activity of its various funds.

The CAFR is presented in three sections: introductory, financial, and statistical. The introductory section includes this transmittal letter, a list of elected City officials, organizational charts for the Office of the City Controller and for Houston's City Government, and a copy of the Government Finance Officers Association's Certificate of Achievement for Excellence in Financial Reporting for the City's 2002 CAFR. The financial section includes Management's Discussion and Analysis (MD&A), basic financial statements, combining and individual fund statements and schedules, as well as the independent auditors' report on the basic financial statements. The MD&A is a narrative introduction, overview, and analysis to accompany the basic financial statements. The statistical section includes selected financial and demographic information generally presented on a multi-year basis.

The Financial Section described above is prepared in accordance with generally accepted accounting principles (GAAP) for governments as prescribed by the Governmental Accounting Standards Board (GASB).

The Reporting Entity and Its Services

The Basic Financial Statements of the City include all government activities, organizations and functions, including those legally separate organizations for which the City is financially accountable as defined by the GASB.

The City provides a full range of municipal government services to approximately 1.9 million residents and to an estimated 20 million conventioners and other visitors annually. Municipal services provided include police and fire protection, emergency medical services, pretrial detention services, traffic and municipal courts, water production and distribution, solid waste collection and disposal, sanitary code enforcement, wastewater treatment, health and human services, building and housing code enforcement, construction and maintenance of streets and bridges, traffic signal installation and maintenance, parks and recreation, library, convention and entertainment activities, and operation of three airports: George Bush Intercontinental Airport, William P. Hobby Airport and Ellington Field.

The City does not operate hospitals, schools, transportation systems, or higher education systems. Special districts and governmental entities with independent taxing authority administer the public hospitals, public schools, and mass transit system within the City.

The Local Economy and Outlook

Although still known as the energy capital of the world, Houston's economy continues to diversify. This diversification has reduced Houston's vulnerability to downturns in the energy industry. Today, 54% of the area's employment base is in jobs unrelated to energy. Houston is a leader in aerospace and space commerce, medicine, computer technology, biotechnology, engineering and construction, transportation, and telecommunications. Houston is a major corporate center, ranking fifth among U. S. metropolitan areas in the number of corporate headquarters of Fortune 500 companies with 19. Nearly half of the world's 100 largest non-U.S.-based corporations have operations in Houston.

With a population of more than 1.9 million, Houston is the fourth largest city in the country and the largest city in Texas. Seventy-seven foreign governments have consular offices in Houston. Many also maintain trade offices in the City. Forty international chambers of commerce and trade associations have established themselves in Houston. In addition, 22 foreign banks representing 11 nations operate in Houston, providing financial assistance to the international community.

Houston is among the nation's fastest-growing and culturally diverse metropolitan areas in the U.S. The 2000 census found that no racial or ethnic group constitutes a majority of the metro area population. The City's population is 37.4% Hispanic, 30.8% Caucasian, 25% African-American, 5.5% Asian, .1% other and 1.2% bi-or multi-racial. Among the nation's largest metropolitan areas, Houston ranks fifth in Hispanic population and 10th in Asian and Pacific Islander population. The City prizes its ethnic diversity as a source of strength in a global economy. Over 150 different countries are represented in Houston's populace and more than 100 different languages are spoken here.

Houston has a highly skilled workforce and well-educated populace. Nearly 250,000 students are enrolled in more than 500 degree and certification programs at 40-plus colleges, community colleges, and institutes. More than 25% of adult Houstonians have completed four or more years of college, compared to about 20% nationally.

The outlook for the Houston economy is unclear. The unemployment rate for October 2003 was 6.3% and the area's job total was 5800 short of last year. In October, the Greater Houston Partnership predicted that the rate of job loss appeared to be slowing, noting that the 12-month net job loss had peaked in June 2003 at 16,300. The Partnership noted that like the rest of the nation, Houston has seen job growth stymied by extraordinarily rapid gains in productivity, by lack of confidence that the economy will expand fast enough and long enough to justify increasing payrolls and investment, and by rising costs associated with additions to payroll. On the other hand, lower mortgage rates have helped to spur sales of new and existing homes. Single-family housing starts are expected to surpass 37,000 this year, topping last year's record.

According to the Houston Multiple Listing Service, the number of closings through October was running 7% ahead of 2002, while the number of active listings was 13% greater than a year ago. Used-home sales are also on course to set a record. Through November, 58,409 existing homes had been sold in Houston for a 6.5% gain from the previous year.

Throughout the City

Many exciting changes are underway in Houston. The most exciting is probably the addition of light rail. A 7.5-mile light rail system will begin operation between downtown Houston and Reliant Park early in 2004. The \$324 million project will provide transportation between downtown's offices and entertainment venues, the Texas Medical Center, Hermann Park and the Houston Zoo, the Museum District, Rice University, The University of Houston-Downtown, Houston Community College and Reliant Park. Overhead wires power the trains electrically. Each train is able to carry over 200 passengers. The initial fleet will consist of 15 cars.

Local voters recently approved \$4.6 billion of transit improvements. The Metro Solutions Transit Plan includes an additional 22 miles of light rail, 44 extra bus routes, additional High Occupancy Vehicle (HOV) Lanes, and \$774 million in new roadwork. The Metropolitan Transit Authority of Harris County (METRO) serves 1,281 square miles and operates more than 1,400 buses.

The Houston area is fast becoming a preferred destination for the World's biggest and most prestigious sporting events. Super Bowl XXXVIII is scheduled for February 1, 2004 at Reliant Park. This is expected to bring more than 100 thousand visitors to town. A Super Bowl Host Committee of more than 200 business and community leaders is serving as the liaison between the National Football League and local efforts. The panel will coordinate a wide variety of services, including transportation, security, marketing, special events, minority business development, public relations, volunteer recruitment and hospitality. Later in 2004, Houston will host Major League Baseball's All-Star Game and the Tennis Masters Cup. In 2011, the NCAA men's Final Four will return to Houston. Other events that may be coming to the City in future years include the Gymnastic Olympic Trials, the Big XII Football Championship, the Big XII Basketball Tournament, and the NBA All-Star Game.

Houston's billion-dollar investment in new ballparks and arenas, as well as the revitalization of downtown are believed to be the reasons the City is winning the bid competitions for these major events. The Toyota Center is downtown's newest sports venue. The \$175 million dollar arena is home to the Houston Rockets NBA basketball team, the Houston Comets WNBA basketball team, and the Houston Aeros AHL hockey team. The facility has 92 luxury suites and can seat 18,500 for basketball, 17,800 for hockey, and 19,300 for concerts. Reliant Stadium opened at the start of the 2002 football season and is home to the new Houston Texans NFL team and the Houston Livestock Show and Rodeo. Minute Maid Park, the home of the Houston Astros baseball team, opened in 2000.

Since 1995, nearly \$3 billion of construction projects have been completed in downtown Houston. According to the Downtown Houston Management District, another \$347 million of projects are on the drawing board. Among the improvements is the management district's \$62 million Cotswold Project, a total remake of downtown's 90-block historic center. The project includes landscaping, new streetlights, fountains, and improved parking. It is expected to make downtown streets more pedestrian-friendly. The Downtown Houston Management District is also coordinating construction on the three-block long Main Street Square project, which will feature fountains jetting water over Metro's new light rail trains. Another endeavor, the Metro Transit Streets Project, involves the total rebuilding of 20 downtown streets.

The project includes work both above and below the street surface. Underground sewer and sanitation systems, some nearly 100 years old, are being rebuilt. Fiber optic cable and electrical wiring are being replaced and realigned to fit around the new pipes.

A new aquatic-themed entertainment and dining complex opened in early 2003. Landry's Restaurants converted Fire Station Number 1 and the historic Central Water Works Plant into a five-acre entertainment and dining complex complete with a 400-seat seafood restaurant, a casual café, 500,000-gallon aquariums featuring 200 species of marine life, a 200,000-gallon shark tank, a Ferris wheel, and a gas powered train. Near the aquarium is Bayou Place, a 155,000 square foot entertainment complex featuring a multiplex cinema, a concert hall, and restaurants. A 40,000 square foot expansion of Bayou Place is planned.

More than 30 new restaurants and clubs have arrived on the scene in recent years, making downtown a destination for nightlife. Downtown also houses a variety of renowned performing arts organizations. The 17-block downtown theater district is second in seating to New York's Broadway and attracts over 2-million people annually. The district is home to the Houston Grand Opera, the Houston Ballet, the Houston Symphony, Theater Under the Stars, and the Tony Award-winning Alley Theater. The new Hobby Center for the Performing Arts opened in the spring of 2002. The center's current line-up of shows includes "The Graduate," "Grease," and "The Full Monty."

The new downtown convention center hotel and an expanded George R. Brown Convention Center opened in December 2003. The Hilton Americas-Houston is connected to the convention center and a 1,600-stall parking garage by elevated pedestrian sky bridges. The hotel features 1,200 guest rooms and 70,000 square feet of meeting space including two ballrooms. The new hotel and the additional space at the convention center are expected to greatly increase Houston's capacity to host large conventions. 20 thousand conventioners are expected for The Diving Equipment Marketing Association conventions in 2004, 2007, and 2010. Recurring annual events for the Offshore Technology Conference and the International Quilt Market and Quilt Festival, both of which attract approximately 50,000 visitors.

The City's Museum District has much to offer visitors and local arts enthusiasts. The district is home to 11 museums, including the Museum of Fine Arts, Houston (MFAH); the 6th largest art museum in the nation in terms of exhibition space. The Audrey Jones Beck Building which opened in 2000 more than doubles the MFAH's galleries for the display of its permanent collection and special exhibitions. With over half a million in attendance annually, the Children's Museum boasts the highest attendance for a youth museum of its size in the country. The Houston Museum of Natural Science ranks as the fourth most highly attended museum in the nation and is 2nd in attendance to the Houston Astros Baseball Club in the city of Houston. Founded in 1948, the Museum of Contemporary Art prides itself on presenting changing exhibits of new-direction art and modern-day masters, largely created over the past 40 years. The Holocaust Museum Houston Education Center and Memorial is the sixth largest institution of its kind in the country.

Other museums in the district include: the Menil Collection, The Lawndale Center, the Houston Center for Photography, the Museum of Health and Medical Science, the Houston Center for Contemporary Craft and the Buffalo Soldiers National Museum.

In order to meet the demand of a growing number of passengers, the Houston Airport System has embarked on a \$2.6 billion capital improvement program for what is already the 6th largest multi-airport system in the world. A new \$125 million air cargo center opened at George Bush Intercontinental Airport in early 2003. Seven gates of the airport's new 23-gate international terminal opened in June. An adjoining federal inspection station, which will house the U.S. Customs and Immigration Service, will be

completed in early 2005. The 20-year expansion plan for Hobby Airport will add ten new gates and double on-site parking. Ellington Field is slated to receive runway improvements and new cargo hangers. These improvements are being financed entirely through Federal Aviation Administration Grants and revenue bonds secured by the money the City receives from the airlines, parking and concessions.

Another major contributor to the area economy is the Port of Houston. In 2002, the Port's Barbours Cut terminal posted yet another record year by handling more than one million containers. To relieve pressure on the Barbours Cut terminal, the Port Authority has proposed building the Bayport Container and Cruise Terminal. The Bayport project will feature three berths to accommodate cruise ships. Norwegian Cruise Lines (NCL) is returning to the Port of Houston. Under terms of the three-year agreement, NCL's Norwegian Sea will offer 7-day cruises to the Western Caribbean. The arrival of the Norwegian Sea is part of a massive expansion of cruise offerings from the ports of Galveston and Houston. A total of five ships now sail from Texas ports.

Like the rest of the nation, Houstonians mourned the loss of the space shuttle Columbia and its crew of seven last February. The loss was felt especially hard in Houston's Clear Lake area, the home of Johnson Space Center (JSC) where shuttle crews are trained. NASA and JSC are working to move the space program forward. We are confident the space industry will continue to have a large influence in the Houston area.

Financial Information

Accounting System and Budgetary Control

The mayor serves as the Chief Executive of the City. The City Controller is the second highest elected official within City government and serves as the City's Chief Financial Officer. The legislative body of the City is the City Council, which consists of nine district members and five at-large members. The Mayor, City Controller, and Council Members are limited to three two-year elected terms.

The City's management is responsible for establishing and maintaining a system of internal controls designed to provide reasonable, but not absolute assurance, that the assets of the City are protected from loss, theft, or misuse and the reliability of financial records for preparing financial statements and maintaining accountability assets. The concept of reasonable assurance recognizes that the cost of a control should not exceed the benefits likely to be derived and that the evaluation of costs and benefits requires estimates and judgments by management.

As part of its internal control structure, the City is required to adopt a balanced budget each year. Based upon recommendations by the Mayor, City Council adopts an annual budget for the General Fund, Debt Service Fund, and Special Revenue Funds. Exceptions are the Grant Revenue, Disaster Recovery, Health Special and Housing Special Revenue Funds, for which City Council adopts separate operating or program budgets throughout the year.

Also, based upon the Mayor's recommendations, City Council adopts an annual budget for maintenance and operating expenses, excluding depreciation, debt service, and other capital costs of the proprietary funds. The City Council also appropriates available resources to authorize expenditures pursuant to those budgets. The City does not budget capital projects and other expenditures. Instead, City Council authorizes these expenditures through individual appropriation ordinances. No City expenditures may be made without a duly adopted ordinance. City Council can legally appropriate only those amounts of money that the City Controller has previously certified.

Although the legal level of budgetary control is the departmental level within a fund, the City maintains internal budgetary control at the expenditure category (i.e., Personnel Services, Supplies, Other Services and Capital Outlay). Budget control is primarily managed using an automated encumbrance and accounts payable system.

The City is required to undergo an annual Single Audit in conformity with the provisions of the Single Audit Act, the U. S. Office of Management and Budget Circular A-133, "Audits of State, Local Governments and Non-profit Organizations," and the State of Texas Single Audit Circular. These audits are conducted simultaneously with the City's annual financial statement audit. Information related to these Single Audits, including the schedules of financial assistance, findings and recommendations, and auditors' reports on the internal control structure and compliance with applicable laws and regulations is included in separate Single Audit Reports.

Award

The Government Finance Officers Association (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the City for its Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2002. The Certificate of Achievement is a prestigious national award, recognizing conformance with the highest standards for preparation of a state and local government financial reports.

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

A Certificate of Achievement is valid for a period of one year only. We believe our current report continues to conform to the Certificate of Achievement program requirements, and we are submitting it to GFOA.

Acknowledgements

The preparation of this report on a timely basis could not have been accomplished without the dedicated services and hard work of a highly qualified staff. The City of Houston has such a staff in the City Controller's Office. Although much time and effort in preparation of this report lies in the Financial and Technical Services Division, they were supported by the other divisions of the Office: Executive, Administration, Treasury, and Audit. I would like to express my appreciation to all the staff of the City Controller's Office, and to the staff of the Finance and Administration, Aviation, Convention and Entertainment Facilities, and Public Works and Engineering departments who assisted and contributed to the preparation of this report.

The City Controller's Office also received invaluable assistance and support from many others outside our immediate organization. Within the City of Houston, the accounting staffs of the operating departments and the technical staff of the Information Services Division all played key roles in producing this report. The design is the creative work of Carlos St. Mary of PMG Advertising and Marketing. Deloitte & Touche LLP was not only our independent auditor, but also served as an invaluable source of information and ideas for improving the way that City finances are reported.

Finally, we acknowledge the Mayor and City Council Members who have consistently supported the City's goal of excellence in all aspects of financial management. Their support during my tenure as City Controller is greatly appreciated.

Special thanks are gratefully given to the Greater Houston Partnership, the Houston International Festival, the Houston Convention and Visitors Bureau and Melissa Tatum at the City of Houston's Parks and Recreation Department. The photos provided by these groups beautifully showcase Houston's rich, ethnic diversity. We are justly proud and hope that this CAFR provides readers with a glimpse of this truly extraordinary international city.

Request for Information

This financial report is designed to provide a general overview of the City of Houston'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 the Office of City Controller, 901 Bagby, Suite 800, Houston, Texas 77002.



Judy Gray Johnson
City Controller

Sources:

Buffalo Bayou Partnership
Greater Houston Convention and Visitors Bureau
Greater Houston Partnership
Houston Chronicle
Houston Convention Center Hotel Corporation
Houston Downtown Management District
Houston METRO Transit Authority
Port Authority of Houston

Certificate of Achievement for Excellence in Financial Reporting

Presented to

City of Houston,
Texas

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2002

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



President

Executive Director