

**DENTON COUNTY FRESH WATER SUPPLY
DISTRICT NO. 1-H**

ANNUAL FINANCIAL REPORT

SEPTEMBER 30, 2010

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INDEPENDENT AUDITOR'S REPORT

Board of Directors
Denton County Fresh Water Supply
District No. 1-H
Denton County, Texas

We have audited the accompanying financial statements of the governmental activities and each major fund of Denton County Fresh Water Supply District No. 1-H (the District), as of and for the year ended September 30, 2010, which collectively comprise the District's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the District's management. Our responsibility is to express 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. 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 includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our 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 September 30, 2010, 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.

In accordance with *Government Audit Standards*, we have also issued our report dated March 18, 2011 on our consideration of the District's internal control over financial reporting and our test 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* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and budgetary comparison information on pages 3 through 8 and 30 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 historical context.

Denton County Fresh Water Supply
District No. 1-H

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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, and other knowledge we obtained during our audit of 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.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the District's basic financial statements. The supplementary information listed in the table of contents on pages 31 through 38 are required by the Texas Commission on Environmental Quality as published in the *Water District Financial Management Guide* and are not a required part of the basic financial statements. The accompanying supplementary information, excluding the portion marked "Unaudited" have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Weaver and Tidwell, L.L.P.

WEAVER AND TIDWELL L.L.P.

Dallas, Texas
March 18, 2011

**DENTON COUNTY FRESH WATER SUPPLY DISTRICT NO. 1-H
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED SEPTEMBER 30, 2010**

Our discussion and analysis of Denton County Fresh Water Supply District No. 1-H's (the District) financial performance provides an overview of the District's financial activities for the fiscal year ended September 30, 2010. Please read it in conjunction with the District's financial statements, which begin on page 9.

FINANCIAL HIGHLIGHTS

- The assets of the District exceeded its liabilities at September 30, 2010 by \$681,823. Of this amount, \$1,922,366 is invested in capital assets which do not directly generate revenue and are not available to generate liquid capital. A deficit balance of \$1,240,543 remains as unrestricted.
- The District's net assets decreased by \$259,096. The primary cause of the decrease is the current phase of development within the District. Currently the District has limited revenue sources to cover its operating costs.
- At the close of the current fiscal year, the District's governmental funds reported combined ending deficit fund balances of \$880,257, a net decrease of \$215,458 in comparison to the prior year. The decrease is a direct result of the stage of development where the District currently is in where the District is incurring costs with minimal sources of income.

OVERVIEW OF THE FINANCIAL STATEMENTS

This annual report consists of a series of financial statements. The basic financial statements include: (1) combined fund financial statements and government-wide financial statements and (2) notes to the financial statements. The combined fund financial statements and government wide financial statements combine both: (1) the Statement of Net Assets and Governmental Funds Balance Sheet and (2) the Statement of Activities and Governmental Fund Revenues, Expenditures and Changes in Fund Balances. This report also includes other supplementary information in addition to the basic financial statements.

Government-wide financial statements

The District's annual report includes two financial statements combining the government-wide financial statements and the fund financial statements. The government-wide portion of these statements provides both long-term and short-term information about the District's overall status. Financial reporting at this level uses a perspective similar to that found in the private sector with its basis in full accrual accounting and elimination or reclassification of internal activities.

The first of the government-wide statements is the statement of net assets. This information is found in the statement of net assets column on pages 9 and 10. The statement of net assets is the District-wide statement of its financial position presenting information that includes all of the District's assets and liabilities, with the difference reported as net assets.

**DENTON COUNTY FRESH WATER SUPPLY DISTRICT NO. 1-H
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED SEPTEMBER 30, 2010**

Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the District as a whole is improving or deteriorating. Evaluation of the overall health of the District would extend to other non-financial factors.

The government-wide portion of the statement of activities on pages 12 and 13 reports how the District's net assets changed during the current fiscal year. All current year revenues and expenses are included regardless of when cash is received or paid.

Fund financial statements

The combined statements also include 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 has two governmental fund types. The General Fund accounts for resources not accounted for in another fund, customer service revenues, costs and general expenditures. The Capital Projects Fund accounts for financial resources segregated for acquisition or construction of facilities and related costs.

Governmental funds are reported in each of the financial statements. The focus in the fund statements provides a distinctive view of the District's governmental funds. These statements report short-term fiscal accountability focusing on the use of spendable resources and balances of spendable resources available at the end of the year. They are useful in evaluating annual financing requirements of the District and the commitment of spendable resources for the near-term.

Since the government-wide focus includes the long-term view, comparisons between these two perspectives may provide insight into the long-term impact of short-term financing decisions. The adjustment column, the reconciliation of the governmental funds balance sheet to the statement of net assets on page 11 and the reconciliation of the governmental funds statement of revenues, expenditures and changes in the fund balances to the statement of activities on page 14 explain the differences between the two presentations and assist in understanding the differences between these two perspectives.

Notes to the basic financial statements

The accompanying notes to the basic financial statements provide information essential to a full understanding of the government-wide and fund financial statements. The notes to the financial statements can be found on pages 15 through 29 in this report.

Other information

In addition to the basic financial statements and accompanying notes, this report also presents certain required supplementary information (RSI). A budgetary comparison schedule is included as RSI for the General Fund. Additionally, information required by the Texas Commission on

**DENTON COUNTY FRESH WATER SUPPLY DISTRICT NO. 1-H
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED SEPTEMBER 30, 2010**

Other information - Continued

Environmental Quality as published in the *Water District Financial Management Guide* is included as other supplementary information.

GOVERNMENT-WIDE FINANCIAL ANALYSIS

Net assets may serve over time as a useful indicator of the District's financial position. In the case of the District, assets exceeded liabilities by \$681,823 as of September 30, 2010.

The following is a comparative analysis of the government-wide changes in net assets:

	Summary of Changes in the Statement of Net Assets		
	<u>2010</u>	<u>2009</u>	<u>Change</u>
Current and other assets	\$ 1,408	\$ 5,118	\$ (3,710)
Capital assets (Net of accumulated depreciation)	<u>1,922,366</u>	<u>1,966,004</u>	<u>(43,638)</u>
Total assets	<u>1,923,774</u>	<u>1,971,122</u>	<u>(47,348)</u>
Long-term liabilities	360,286	360,286	-
Other liabilities	<u>881,665</u>	<u>669,917</u>	<u>211,748</u>
Total liabilities	<u>1,241,951</u>	<u>1,030,203</u>	<u>211,748</u>
Net assets			
Invested in capital assets	1,922,366	1,605,718	316,648
Unrestricted	<u>(1,240,543)</u>	<u>(664,799)</u>	<u>(575,744)</u>
Total net assets	<u><u>\$ 681,823</u></u>	<u><u>\$ 940,919</u></u>	<u><u>\$ (259,096)</u></u>

**DENTON COUNTY FRESH WATER SUPPLY DISTRICT NO. 1-H
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED SEPTEMBER 30, 2010**

GOVERNMENT-WIDE FINANCIAL ANALYSIS (Continued)

The following table provides a summary of the District's operations for the years ended September 30, 2010 and 2009. The District's net assets decreased by \$259,096, accounting for a 27.5% decrease in net assets.

	Summary of Changes in the Statement of Activities		
	2010	2009	Change
Revenues:			
Charges for services	\$ 8,472	\$ 1,311	\$ 7,161
Other revenues	-	4	(4)
Total revenues	<u>8,472</u>	<u>1,315</u>	<u>7,157</u>
Expenses for services	<u>267,568</u>	<u>679,946</u>	<u>(412,378)</u>
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	<u>(259,096)</u>	<u>(678,631)</u>	<u>419,535</u>
OTHER FINANCING SOURCES	<u>-</u>	<u>1,358,225</u>	<u>(1,358,225)</u>
Change in net assets	(259,096)	679,594	(938,690)
Net assets, beginning of year	<u>940,919</u>	<u>261,325</u>	<u>679,594</u>
Net assets, end of year	<u><u>\$ 681,823</u></u>	<u><u>\$ 940,919</u></u>	<u><u>\$ (259,096)</u></u>

FINANCIAL ANALYSIS OF THE DISTRICT'S GOVERNMENTAL FUNDS

The District's combined fund balances as of September 30, 2010, were a deficit \$880,257, a decrease of \$215,458 from the prior year.

The General Fund balance decreased by \$215,458, primarily due to minimal revenue collected from charges for services.

The Capital Projects Fund balance did not change.

**DENTON COUNTY FRESH WATER SUPPLY DISTRICT NO. 1-H
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED SEPTEMBER 30, 2010**

GENERAL FUND BUDGETARY HIGHLIGHTS

Actual expenditures on a budgetary basis were \$199,769 compared to the amended budget of \$143,242. The negative budget variance of \$56,527 was primarily due to professional fees. Actual Revenue on a budgetary basis was \$8,472 compared to the amended budget of \$1,429. The positive variance is primarily due to the receipt of sales tax revenue. See the budget to actual comparison on page 30 for additional information.

CAPITAL ASSETS

A portion of the District's assets were funded by Denton County per an agreement with Denton County Fresh Water Supply District No. 1-A (District 1-A). Per the agreement, Denton County funded construction costs of the Windhaven Parkway West project which lies partially within the District. The District also shares in the cost of the capital assets that District 1-A purchases and records on its books.

The District's investment in capital assets as of September 30, 2010 amounts to \$1,922,366 (net of accumulated depreciation).

Capital Assets at Year-End, Net of Accumulated Depreciation

	2010	2009	Increase (Decrease)
Construction in progress	\$ 132,949	\$ 132,949	\$ -
Water system	922,207	946,016	(23,809)
Wastewater system	563,680	576,569	(12,889)
Drainage system	15,923	16,287	(364)
Roads	287,607	294,183	(6,576)
Total net capital assets	<u>\$ 1,922,366</u>	<u>\$ 1,966,004</u>	<u>\$ (43,638)</u>

Additional information on the District's capital assets can be found in Note 4 on pages 22 and 23 of this report.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

In the 2010-2011 Budget, revenues are anticipated to decrease by approximately \$2,000 from the 2009-10 budget year, primarily to water sales. Expenses for the FY 2010-11 are anticipated to decrease by approximately \$27,700 due to reductions in maintenance and operating costs. The General Fund, which is comprised of the District's General Fund, Operating Fund, and Utility Fund, is budgeted to operate next year with expenditures more than revenues.

**DENTON COUNTY FRESH WATER SUPPLY DISTRICT NO. 1-H
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED SEPTEMBER 30, 2010**

The FY 2010/2011 budget has been divided into three funds for accounting purposes; the General Fund, Operations Fund, and a Utility Fund, primarily to measure various expenditures against supporting revenue items. Another change in accounting is also the method expenditures are charged to the District. All expenditures, with the exception of District Direct expenses and District Usage expenses, are billed to District 1-A. Subsequently, each of District 1-A's expenses are billed to the District as a 1-A reimbursement.

CONTACTING THE DISTRICT'S FINANCIAL MANAGEMENT

This financial report is designed to provide a general overview of the District's finances. Questions concerning any of the information provided in this report or requests for additional information should be addressed to Denton County Fresh Water Supply District No. 1-H, c/o Kelly Hart & Hallman LLP, 201 Main Street, Suite 2500, Fort Worth, TX 76102.

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**DENTON COUNTY FRESH WATER SUPPLY DISTRICT NO. 1-H
STATEMENT OF NET ASSETS AND
GOVERNMENTAL FUNDS BALANCE SHEET
SEPTEMBER 30, 2010**

	General Fund	Capital Projects Fund
ASSETS		
Prepaid costs	\$ 1,408	\$ -
Construction in progress	-	-
Capital assets (net of accumulated depreciation)	-	-
TOTAL ASSETS	\$ 1,408	\$ -
LIABILITIES		
Accounts payable	\$ 21,404	\$ -
Due to other governmental units	860,261	-
Total liabilities	881,665	-
FUND BALANCES/NET ASSETS		
FUND BALANCES		
Reserved for prepaid costs	1,408	-
Unreserved - undesignated	(881,665)	-
Total fund balances	(880,257)	-
TOTAL LIABILITIES AND FUND BALANCES	\$ 1,408	\$ -
NET ASSETS		
Invested in capital assets		
Unrestricted		
TOTAL NET ASSETS		

The Notes to Financial Statements are an integral part of these statements.

<u>Total</u>	<u>Adjustments</u>	<u>Statement of Net Assets</u>
\$ 1,408	\$ -	\$ 1,408
-	132,949	132,949
-	1,789,417	1,789,417
<u>\$ 1,408</u>	<u>\$ 1,922,366</u>	<u>\$ 1,923,774</u>
\$ 21,404	\$ -	\$ 21,404
860,261	360,286	1,220,547
<u>881,665</u>	<u>360,286</u>	<u>1,241,951</u>
1,408	(1,408)	-
(881,665)	881,665	-
<u>(880,257)</u>	<u>880,257</u>	<u>-</u>
<u>\$ 1,408</u>		
	1,922,366	1,922,366
	(1,240,543)	(1,240,543)
	<u>\$ 681,823</u>	<u>\$ 681,823</u>

**DENTON COUNTY FRESH WATER SUPPLY DISTRICT NO. 1-H
RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET
TO THE STATEMENT OF NET ASSETS
SEPTEMBER 30, 2010**

Total Fund Balances - Governmental Funds	\$ (880,257)
Amounts reported for governmental activities in the statement of net assets are different because:	
Construction in progress in governmental activities is not a financial resource and therefore is not reported as an asset in the governmental funds.	132,949
Capital assets used in governmental activities are not financial resources and therefore are not reported as assets in the governmental funds.	1,789,417
Governmental funds do not record a long term liability to other governmental units for the advances made on behalf of the District for operations and project costs. However, in the statement of net assets, the liability for these advances is recorded.	<u>(360,286)</u>
Total Net Assets - Governmental Activities	<u><u>\$ 681,823</u></u>

The Notes to Financial Statements are an integral part of these statements.

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**DENTON COUNTY FRESH WATER SUPPLY DISTRICT NO. 1-H
STATEMENT OF ACTIVITIES AND GOVERNMENTAL FUND REVENUES,
EXPENDITURES AND CHANGES IN FUND BALANCES
FOR THE YEAR ENDED SEPTEMBER 30, 2010**

	General Fund	Capital Projects Fund
REVENUES:		
Water service	\$ 1,168	\$ -
Wastewater service	123	-
Penalty and interest	3	-
Permits and inspections	2,429	-
Sales tax revenues	4,749	-
	<u>8,472</u>	<u>-</u>
Total Revenues	<u>8,472</u>	<u>-</u>
EXPENDITURES/EXPENSES		
Service operations:		
Personnel	216	-
Professional fees	93,747	24,161
Contracted services	15,361	-
Purchased water service	33,628	-
Purchased wastewater service	14,642	-
Purchased non-potable water service	6,741	-
Utilities	3,975	-
Repairs and maintenance	16,629	-
Other	14,830	-
Depreciation	-	-
	<u>199,769</u>	<u>24,161</u>
Total expenditures/expenses	<u>199,769</u>	<u>24,161</u>
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	<u>(191,297)</u>	<u>(24,161)</u>
OTHER FINANCING SOURCES (USES)		
Transfer in (out)	(24,161)	24,161
	<u>(24,161)</u>	<u>24,161</u>
Total other financing sources (uses)	<u>(24,161)</u>	<u>24,161</u>
NET CHANGE IN FUND BALANCES	(215,458)	-
CHANGE IN NET ASSETS		
FUND BALANCES/NET ASSETS AT OCTOBER 1, 2009	<u>(664,799)</u>	<u>-</u>
FUND BALANCES/NET ASSETS AT SEPTEMBER 30, 2010	<u>\$ (880,257)</u>	<u>\$ -</u>

The Notes to Financial Statements are an integral part of these statements.

<u>Total</u>	<u>Adjustments</u>	<u>Statement of Activities</u>
\$ 1,168	\$ -	\$ 1,168
123	-	123
3	-	3
2,429	-	2,429
4,749	-	4,749
<u>8,472</u>	<u>-</u>	<u>8,472</u>
216	-	216
117,908	-	117,908
15,361	-	15,361
33,628	-	33,628
14,642	-	14,642
6,741	-	6,741
3,975	-	3,975
16,629	-	16,629
14,830	-	14,830
-	43,638	43,638
<u>223,930</u>	<u>43,638</u>	<u>267,568</u>
<u>(215,458)</u>	<u>(43,638)</u>	<u>(259,096)</u>
<u>-</u>	<u>-</u>	<u>-</u>
<u>-</u>	<u>-</u>	<u>-</u>
(215,458)	215,458	
	(259,096)	(259,096)
<u>(664,799)</u>	<u>1,605,718</u>	<u>940,919</u>
<u>\$ (880,257)</u>	<u>\$ 1,562,080</u>	<u>\$ 681,823</u>

**DENTON COUNTY FRESH WATER SUPPLY DISTRICT NO. 1-H
RECONCILIATION OF THE GOVERNMENTAL FUNDS STATEMENT OF
REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
TO THE STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED SEPTEMBER 30, 2010**

Net Change in Fund Balances - Governmental Funds \$ (215,458)

Governmental funds do not account for depreciation. However, in the statement of net assets, capital assets are depreciated over the estimated useful life of the asset and depreciation expense is recorded in the statement of activities.

(43,638)

Change in Net Assets - Governmental Activities

\$ (259,096)

**DENTON COUNTY FRESH WATER SUPPLY DISTRICT NO. 1-H
NOTES TO BASIC FINANCIAL STATEMENTS**

NOTE 1. CREATION OF DISTRICT

By the terms of an election held on January 17, 1983, voters approved the creation of the Denton County Fresh Water Supply District No. 1, now known as Denton County Fresh Water Supply District No. 1-A (District No. 1-A). As a result of another election held on August 8, 1987, the voters approved the District's assumption of certain rights, authority, privileges and functions of a road district and approved for the District to purchase, construct, acquire, own, operate, repair, improve and extend sanitary sewer systems. On December 21, 1993, following a hearing, the governing board of the District approved the conversion of the District to a Water Control and Improvement District and conversion to operating under Chapter 51 of the Texas Water Code and specifically reserved certain rights under Sections 53.029, 53.030 through 53.035, 53.037 through 53.041, 53.111, 53.112, 53.121, and 53.125 of the Texas Water Code.

At an election held within the boundaries of the District on May 10, 2008 voters approved the division of District 1-A into two new districts of which Denton County Fresh Water Supply District No. 1-H (the District) was one. The District held its first meeting on June 17, 2008. Pursuant to the provisions of Chapters 49, 51 and 53 of the Texas Water Code, the District is empowered to purchase, operate and maintain all facilities, plants and improvements necessary to provide water, sanitary sewer service, storm sewer drainage, irrigation, solid waste collection and disposal, including recycling, parks and recreational facilities for the residents of the District. The District is also empowered to contract for or employ its own peace officers with powers to make arrests and to establish, operate and maintain a fire department to perform all fire-fighting activities within the District. The District has contracted with District No. 1-A to operate the utility system within the District.

NOTE 2. SIGNIFICANT ACCOUNTING POLICIES

The accompanying basic financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America as promulgated by the Governmental Accounting Standards Board. In addition, the accounting records of the District are maintained generally in accordance with the Water District Financial Management Guide published by the Commission.

Under Governmental Accounting Standards Board (GASB) 14 established the criteria for determining whether or not a given entity is a component unit. The criteria are: (1) is the potential component unit a legally separate entity, (2) does the primary government appoint a voting majority of the potential component unit's board, (3) is the primary government able to impose its will on the potential component unit, (4) is there a financial benefit or burden relationship. The District was created as a governmental entity. GASB 39 added clarification to GASB 14 by including entities which meet all three of the following requirements:

1. The economic resources received or held by the separate organization are entirely for the direct benefit of the primary government, its component units, or its constituents.

DENTON COUNTY FRESH WATER SUPPLY DISTRICT NO. 1-H
NOTES TO BASIC FINANCIAL STATEMENTS

NOTE 2. SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

2. The primary government, or its component units, is entitled to, or has the ability to otherwise access, a majority of the economic resources received or held by the separate organization.
3. The economic resources received or held by an individual organization that the specific primary government, or its component units, is entitled to, or has the ability to other access, are significant to that primary government.

The District does not meet the criteria for inclusion as a component unit of any entity nor does any other entity meet the component unit criteria for inclusion in the District's basic financial statements.

Financial Statement Presentation

These financial statements have been prepared in accordance with Governmental Accounting Standards Board (GASB) Statement No. 34-Basic Financial Statements and Management's Discussion and Analysis-for State and Local Governments.

GASB Statement No. 34 established standards for external financial reporting for all state and local government entities, which include a requirement for a Statement of Net Assets and a Statement of Activities. It requires the classification of net assets into three components: Invested in Capital Assets, Net of Related Debt; Restricted; and Unrestricted. These classifications are defined as follows:

- *Invested in Capital Assets, Net of Related Debt* — This component of net assets consists of capital assets, including restricted capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvements of those assets.
- *Restricted Assets* — This component of net assets consists of external constraints placed on the use of net assets imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulation of other governments or constraints imposed by law through constitutional provisions or enabling legislation.
- *Unrestricted Net Assets* — This component of net assets consists of net assets that do not meet the definition of "Restricted" or "Invested in Capital Assets, Net of Related Debt."

When both restricted and unrestricted resources are available for use, generally it is the District's policy to use restricted resources first.

**DENTON COUNTY FRESH WATER SUPPLY DISTRICT NO. 1-H
NOTES TO BASIC FINANCIAL STATEMENTS**

NOTE 2. SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

Government-Wide Financial Statements

The statement of net assets and the statement of activities display information about the District as a whole. The District's statement of net assets and statement of activities are combined with the governmental fund financial statements. The District is viewed as a special purpose government and has the option of combining these financial statements.

The statement of net assets is reported by adjusting the governmental fund types to report on the full accrual basis, economic resource basis, which recognizes all long-term assets and receivables as well as long-term debt and obligations. Any amounts recorded due to and due from other funds are eliminated in the statement of net assets.

The statement of activities is reported by adjusting the governmental fund types to report only items related to current year revenues and expenditures. Items such as capital outlay are allocated over their estimated useful lives as depreciation expense. Internal activities between governmental funds, if any, are eliminated by adjustment to obtain net total revenue and expense of the government-wide statement of activities.

Fund Financial Statements

As discussed above, the District's fund financial statements are combined with the government-wide statements. The fund statements include a Balance Sheet and Statement of Revenues, Expenditures and Changes in Fund Balances.

Governmental Funds

The District has two major governmental funds.

General Fund – To account for resources not required to be accounted for in another fund, customer service revenues, costs and general expenditures.

Capital Projects Fund – To account for financial resources segregated for acquisition or construction of facilities and related costs.

Basis of Accounting

The District uses the modified accrual basis of accounting for governmental fund types. The modified accrual basis of accounting recognizes revenues when both "measurable and available." Measurable means the amount can be determined. Available means collectible within the current period or soon enough thereafter to pay current liabilities. The District considers revenue reported in governmental funds to be available if they are collectible within sixty (60) days after year end.

DENTON COUNTY FRESH WATER SUPPLY DISTRICT NO. 1-H
NOTES TO BASIC FINANCIAL STATEMENTS

NOTE 2. SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

Basis of Accounting – Continued

Also, under the modified accrual basis of accounting, expenditures are recorded when the related fund liability is incurred, except for principal and interest on long-term debt, which are recognized as expenditures when payment is due. Amounts transferred from one fund to another fund are reported as another financing source or use. Loans by one fund to another fund and amounts paid by one fund for another fund are reported as interfund receivables and payables in the Governmental Funds Balance Sheet if there is intent to repay the amount and if the debtor fund has the ability to repay the advance on a timely basis.

Cash and Cash Equivalents

The District cash and cash equivalents are considered to be cash on hand demand deposits and short-term investments with original maturities of three months or less from the date of acquisition.

Prepaid Items

Prepaid balances are for payments made by the District for which benefits extend beyond September 30, 2010, and the reserve for prepaid items has been recognized to signify that a portion of fund balance is not available for other subsequent expenditures.

Capital Assets

Capital assets, which include property, plant, equipment, and infrastructure assets, are reported in the government-wide statement of net assets. All capital assets are valued at historical cost or estimated historical cost if actual historical cost is not available. Donated assets are valued at their fair market value on the date donated. Repairs and maintenance are recorded as expenditure in the governmental fund incurred and as an expense in the government-wide statement of activities. Capital asset additions, improvements and preservation costs that extend the life of an asset are capitalized and depreciated over the estimated useful life of the asset. Interest costs, including developer interest, engineering fees and certain other costs are capitalized as part of the asset.

Assets are capitalized, including infrastructure assets, if they have an original cost greater than \$10,000 and a useful life over two years.

**DENTON COUNTY FRESH WATER SUPPLY DISTRICT NO. 1-H
NOTES TO BASIC FINANCIAL STATEMENTS**

NOTE 2. SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

Capital Assets – Continued

Depreciation is calculated on each class of depreciable property using the straight-line method of depreciation. Estimated useful lives are as follows:

	<u>Years</u>
Buildings	40
Water system	10 - 45
Wastewater system	10 - 45
Drainage system	10 - 45
Road system	10 - 50
All other equipment	3-20

Budgeting

In compliance with governmental accounting principles, the Board of Directors annually adopts an unappropriated budget for the General Fund. The budget was not amended during the current fiscal year.

Pensions

The District does not have employees, except that the Internal Revenue Service has determined that directors are considered to be “employees” for federal payroll tax purposes only. A pension plan has not been established. The District has funded payroll costs to District No. 1-A. District No. 1-A operates the District’s utility system on behalf of the District and handles pension provisions for its employees.

Measurement Focus

Measurement focus is a term used to describe which transactions are recognized within the various financial statements. In the government-wide statement of net assets and statement of activities, the governmental activities are presented using the economic resources measurement focus. The accounting objectives of this measurement focus are the determination of operating income, changes in net assets, financial position, and cash flows. All assets and liabilities associated with the activities are reported. Fund equity is classified as net assets.

Governmental fund types are accounted for on a spending or financial flow measurement focus. Accordingly, only current assets and current liabilities are included on the balance sheet, and the reported fund balances provide an indication of available spendable or appropriable resources.

DENTON COUNTY FRESH WATER SUPPLY DISTRICT NO. 1-H
NOTES TO BASIC FINANCIAL STATEMENTS

NOTE 2. SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

Measurement Focus – Continued

Operating statements of governmental fund types report increases and decreases in available spendable resources. Fund balances are included on the Balance Sheet as follows:

Reserved:

To indicate fund equity which is legally segregated for a specific future use.

Unreserved:

Designated - To indicate fund equity for which the District has made tentative plans.

Undesignated - To indicate fund equity which is available for use in future periods.

Accounting Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

NOTE 3. DEPOSITS AND INVESTMENTS

Deposits

Custodial credit risk is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party. The District's deposit policy for custodial credit risk requires compliance with the provisions of Texas statutes.

Texas statutes require that any cash balance in any fund shall, to the extent not insured by the Federal Deposit Insurance Corporation or its successor, be continuously secured by a valid pledge to the District of securities eligible under the laws of Texas to secure the funds of the District, having an aggregate market value, including accrued interest, at all times equal to the uninsured cash balance in the fund to which such securities are pledged.

As of September 30, 2010, the District does not have any cash deposits.

DENTON COUNTY FRESH WATER SUPPLY DISTRICT NO. 1-H
NOTES TO BASIC FINANCIAL STATEMENTS

NOTE 3. DEPOSITS AND INVESTMENTS – CONTINUED

Investments

Under Texas law, the District is required to invest its funds under written investment policies that primarily emphasize safety of principal and liquidity and that address investment diversification, yield, maturity, and the quality and capability of investment management, and all District funds must be invested in accordance with the following investment objectives: understanding the suitability of the investment to the District's financial requirements, first; preservation and safety of principal, second; liquidity, third; marketability of the investments if the need arises to liquidate the investment before maturity, fourth; diversification of the investment portfolio, fifth; and yield, sixth.

The District's investments must be made "with judgment and care, under prevailing circumstances, that a person of prudence, discretion, and intelligence would exercise in the management of the person's own affairs, not for speculation, but for investment, considering the probable safety of capital and the probable income to be derived." No person may invest District funds without express written authority from the Board of Directors.

Texas statutes include specifications for and limitations applicable to the District and its authority to purchase investments as defined in the Public Funds Investment Act. Authorized investments are summarized as follows: (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, the principal of and interest on which are unconditionally guaranteed or insured by the State of Texas or the United States or its agencies and instrumentalities, (5) certain A rated or higher obligations of states, agencies, counties, cities, and other 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 secured by delivery, (9) certain bankers' acceptances with limitations, (10) commercial paper rated A-i or P-I 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.

As of September 30, 2010, the District does not own any investments.

Restrictions

All cash and investments of the Capital Projects Fund are restricted for the purchase of capital assets.

**DENTON COUNTY FRESH WATER SUPPLY DISTRICT NO. 1-H
NOTES TO BASIC FINANCIAL STATEMENTS**

NOTE 4. CAPITAL ASSETS

A portion of the District's assets were funded by Denton County per an agreement with District No. 1-A. Per the agreement, Denton County funded construction costs of the Windhaven Parkway West project which lies partially within the District. The District also shares in the cost of the capital assets that District 1-A purchases and records on its books.

In addition, the District has recorded capital assets for the utilities and road facilities that have been funded through other available monies, including advances by the Developer of the District.

Capital asset activity for the fiscal year ended September 30, 2010:

	October 1, 2009	Increases	Decreases	September 30, 2010
Capital assets not being depreciated				
Construction in progress	\$ 132,949	\$ -	\$ -	\$ 132,949
Capital assets at historical cost subject to depreciation				
Water system	579,994	-	-	579,994
Wastewater system	16,384	-	-	16,384
Drainage system	295,931	-	-	295,931
Road system	952,343	-	-	952,343
Total capital assets at historical cost subject to depreciation	<u>1,844,652</u>	<u>-</u>	<u>-</u>	<u>1,844,652</u>
Less accumulated depreciation				
Water system	3,425	12,889	-	16,314
Wastewater system	97	364	-	461
Drainage system	1,748	6,576	-	8,324
Road system	6,327	23,809	-	30,136
Total less accumulated depreciation	<u>11,597</u>	<u>43,638</u>	<u>-</u>	<u>55,235</u>
Total depreciable capital assets				
Net of accumulated depreciation	<u>1,833,055</u>	<u>(43,638)</u>	<u>-</u>	<u>1,789,417</u>
Total capital assets, net of accumulated depreciation	<u>\$ 1,966,004</u>	<u>\$ (43,638)</u>	<u>\$ -</u>	<u>\$ 1,922,366</u>

**DENTON COUNTY FRESH WATER SUPPLY DISTRICT NO. 1-H
NOTES TO BASIC FINANCIAL STATEMENTS**

NOTE 4. CAPITAL ASSETS – CONTINUED

On April 19, 2006, a Cost Sharing Agreement was executed between Denton County Fresh Water Supply District Nos. 1-A, 1-B, 1-C, 1-D and 1-E. The agreement provided for a cost sharing of the cost of construction of certain Lift Station Facilities. District No. 1-A will own the facilities for the benefit of the residents and the property located within the original boundaries of Denton County Fresh Water Supply District No. 1, which includes District No. 1-B, District No. 1-C, District No. 1-D and District No. 1-E. On September 30, 2010, the District executed an Excess Capacity Purchase Agreement (ECPA) with District No. 1-A, District No. 1-B, District No. 1-C, District No. 1-D, District No. 1-E, District No. 1-F, and District No. 1-G. This agreement reallocates the shared cost for the construction of the lift station facilities based on capacity. The capacity allocated to each participant was based upon the estimated total sewer connection as of September 30, 2010.

Capacity in the facilities is allocated as follows:

District No. 1-B	36.69 %
District No. 1-C	0.22
District No. 1-D	42.97
District No. 1-E	20.12
Total	100.00 %

District Nos. 1-B, 1-C, 1-D and 1-E are defined in the ECPA as “Selling Districts”. It is the intent of the Selling Districts to sell excess capacity to District Nos. 1-F, 1-G and 1-H based on the actual capacity needed as development occurs within their respective district. The cost of capacity to District Nos. 1-F, 1-G and 1-H will be calculated based upon the provisions outlined in the ECPA.

As of September 30, 2010, the District does not own capacity in the Lift Station Facilities.

NOTE 5. MAINTENANCE TAX

On November 4, 2008, voters of the District approved the levy and collection of a maintenance tax in an unlimited amount per \$100 of assessed valuation of taxable property within the District. During the fiscal year ended September 30, 2010, the District did not levy a maintenance tax. The maintenance tax, when levied, will be used for maintenance purposes to include funds for planning, maintaining, repairing and operating all necessary plants, properties, facilities and improvements of the District and for proper services, engineering and legal fees, and operational and administrative costs in accordance with Section 49.107 of the Texas Water Code.

The Districts tax calendar is as follows:

Levy Date - October 1, or as soon thereafter as practicable.

Lien Date - January 1.

Due Date - Not later than January 31.

Delinquent Date - February 1, at which time the taxpayer is liable for penalty and interest.

**DENTON COUNTY FRESH WATER SUPPLY DISTRICT NO. 1-H
NOTES TO BASIC FINANCIAL STATEMENTS**

NOTE 6. WATER SUPPLY AGREEMENTS

Upper Trinity Regional Water District Regional Treated Water Supply Service Contract for Additional Participating Member

On May 7, 1992, Denton County Fresh Water Supply District No. 1 executed an agreement with the Upper Trinity Regional Water District to provide treated water to participants in the UTRWD. Denton County Fresh Water Supply District No. 1-A has assumed the obligations of District No. 1 under the terms of this agreement and the District has ratified that assumption of the agreement. The UTRWD has agreed to use its best efforts to build the facilities called for in this agreement and to issue debt to fund the cost of the facilities.

The governing body of each contract member, each participating member and the County are entitled to appoint a qualified person to serve on the Board. The governing body of each customer can appoint one member of the governing body or an employee as a member of the Customer Advisory Council of the UTRWD. The Council will consult with and advise the UTRWD and Board on all pertinent matters related to operation of the UTRWD.

The supply of water on a minimum demand, on an interim basis, is for .50 million gallons of water per day (MGD) and 3.0 MGD for regular service. Each member can adjust the regular service amount upon mutual agreement of the members. A determination of demand on an annual basis that takes into account actual usage for the most recent five (5) water years and projected needs for the next water year will be made. Payments will be comprised of three components including an Operation and Maintenance Component, a Capital Component and a special reserve for operation and maintenance cost of the system. Annual budgets will be prepared for the system. The District will pay its part of the annual requirement in monthly installments.

The agreement provides for water conservation and drought contingency issues. The term of the contract is thirty (30) years or as long as the bonds issued remain outstanding. The Contract further has a twenty (20) year extension provision.

Upper Trinity Regional Water District Contract for Non-Potable Water Service with Denton County Fresh Water Supply District No. 1.

On March 8, 1995, the Upper Trinity Regional Water District executed an agreement with the Denton County Fresh Water Supply District No. 1 (District No. 1) to provide for the supply of non-potable water to District No. 1. Denton County Fresh Water Supply District No. 1-A has assumed the obligations of District No. 1 under the terms of this agreement and the District has ratified the actions of District No. 1-A. District No. 1 desired to develop the ability to have a dual delivery system to provide non-potable water and the UTRWD agreed to provide such a water source. District No. 1-A has agreed to make sufficient payments to assure adequate funds to fulfill its obligations under the contract terms. The minimum capacity reserved for District No. 1-A is 3.35 million gallons per day (MGD).

**DENTON COUNTY FRESH WATER SUPPLY DISTRICT NO. 1-H
NOTES TO BASIC FINANCIAL STATEMENTS**

NOTE 6. WATER SUPPLY AGREEMENTS – CONTINUED

Upper Trinity Regional Water District Contract for Non-Potable Water Service with Denton County Fresh Water Supply District No. 1 – Continued

The UTRWD agreed to provide the necessary equipment and devices of standard type required for measuring the quantity of non-potable water delivered. Sixty (60) days after the end of a fiscal year, District No. 1-A will report to UTRWD the number of gallons of non-potable raw water and non-potable treated wastewater effluent used for irrigation, make-up water for lakes and ponds and other purposes. Also reported would be the estimated annual water requirements for each of the next five (5) years for both types of water and an estimate of demand for the next year.

The UTRWD will choose the consulting engineers and provide for the construction of the system to provide the non-potable water. The sale of bonds by the UTRWD will be considered for funding the facilities. Payments will be comprised of three components including an Operation and Maintenance Component, a Capital Component and a special reserve for operation and maintenance cost of the system. Annual budgets will be prepared for the system. District No. 1-A will pay its annual payment including facilities charges and charges for the actual volume of water taken. The agreement is in effect for thirty (30) years from the effective date of the agreement.

Wholesale Water Supply Agreement with the City of Lewisville

On January 28, 2008, District No. 1-A entered into a wholesale water supply agreement with the City of Lewisville (the City). The City agrees to provide wholesale water supply to District No. 1-A for the City Wholesale Service Area. Within the City Wholesale Service Area, District No. 1-A agrees not to use potable water, including ground water, from any source or facilities other than from the City system without the prior written consent of the City Council of the City. District No. 1-A agrees, at its sole expense, to design and construct the infrastructure necessary to enable the City to connect the City system to Castle Hills Subdivision's system.

District No. 1-A will be charged a two-part rate, consisting of a volume rate and a demand rate (Charges), based on the City Wholesale Service Area's treated water consumption and Maximum Day Demand. The initial demand capacity requested from the City is 300,000 gallons per day. Effective the date of this agreement, the initial volume rate is \$1.49 per 1,000 gallons and demand rate of \$299,160 per million gallons per day, paid monthly.

The term of this agreement ends the earlier of August 18, 2032, or such date specified for District 1-A's annexation by the City.

**DENTON COUNTY FRESH WATER SUPPLY DISTRICT NO. 1-H
NOTES TO BASIC FINANCIAL STATEMENTS**

NOTE 7. OPERATING AGREEMENT

Effective October 1, 2008, the District entered into an Operating Agreement with Denton County Fresh Water Supply District No. 1-A (District No. 1-A). District No. 1-A is responsible for operating, maintaining, and managing the Facilities to be constructed within the boundaries of the once defined Denton County Fresh Water Supply District No. 1 which now includes Districts 1-A, 1-B, 1-C, 1-D, 1-E, 1-F, 1-G and 1-H.

District No. 1-A is responsible for preparing and submitting to the District a Facilities Operating and Maintenance Budget (FOMB) by September 1 of each year for the next fiscal year expected to start October 1. With the exception of expenses based on customer usage, if the total actual costs do not exceed the FOMB by more than 12%, the District's revision requests are only advisory. If the reverse is true, the new budget will not take effect until approved by the Board of Directors of the District. District No. 1-A shall be authorized to make expenditures not approved in the FOMB if, 1. Immediately required by law or, 2. Not in excess of \$5,000, with notification efforts being made to the applicable District.

District No. 1-A agreed to handle all aspects of operating the District including contracting for consultants, negotiating with various utility companies, coordinating with various governmental entities, reviewing all statements, invoices and billings, supervising and coordinating contractors, verifying insurance on contractors and facilities and recommending water and sewer rates. District No. 1-A will employ personnel as required.

The District agreed to institute a rate order containing water, sewer, solid waste collection, building permits and inspection fees. District No. 1-A agreed to provide such issuance of permits and inspection fees and management of the utility system. The fees for such permits and inspection services, payable to the District, will be the amount charged for the services. The District agreed to fund a pro-rata portion of overhead cost incurred by District No. 1-A from proceeds of the water, sewer and solid waste collection revenues.

In accordance with the agreement, costs of the maintenance of the facilities within districts of the Castle Hill Subdivision shall be allocated to each district based on the basis of projected water connections. Projected water connections are defined as those new connections that are projected to occur during the next succeeding fiscal year for all the districts. Each district's cost will be calculated based upon a fraction the numerator of which shall be the total number of actual and projected water connections within each district divided by the total number of actual and projected water connections within all the districts. Such fraction shall be calculated as of the first day of the fiscal year in which such fraction is to be used to allocate such costs among the districts and shall be recalculated as of the first of each succeeding fiscal year thereafter.

On September 17, 2008, the District approved the Amended and Restated Operating Agreement. This agreement is to become effective on October 1, 2008. All other provisions remain the same, with the exception of the allocation of the maintenance costs. In accordance with the agreement, costs of the maintenance of the facilities within the districts of the Castle Hills Subdivision shall be allocated to each district on the basis of projected property values.

**DENTON COUNTY FRESH WATER SUPPLY DISTRICT NO. 1-H
NOTES TO BASIC FINANCIAL STATEMENTS**

NOTE 7. OPERATING AGREEMENT – CONTINUED

Projected property values are defined as the combined total value of all property that exists on January 1 of the current fiscal year plus that which is projected to be added during the next succeeding fiscal year for the districts. Each district's cost will be calculated based upon a fraction the numerator of which shall be the total projected property value on January 1 the year immediately following the completion of the fiscal year being budgeted within each district divided by the total projected property value on January 1 the year immediately following the completion of the fiscal year being budgeted within all of the districts. Such fraction shall be calculated as of the first day of the fiscal year in which such fraction is to be used to allocate such costs among the districts and shall be recalculated as of the first day of each succeeding fiscal year thereafter. This agreement terminates on the fortieth (40th) anniversary of October 1, 2008.

NOTE 8. ECONOMIC DEPENDENCY AND DEFICIT FUND BALANCE

The District is contractually obligated to levy sufficient contract taxes to fund the City of Lewisville's Public Improvement District bonds and the District has contracted with Denton County Fresh Water Supply District No. 1-A to conduct District operations. The District is further obligated for significant water supply commitments. The ability to meet all these obligations may require the Developer to advance monies to the District from time to time to meet all the financial obligations and to cover any operating deficits of the District. As of September 30, 2010, the District's General Fund had a deficit fund balance of \$880,257. The District anticipates being able to alleviate this deficit by the sale of water, sewer, drainage and road utilities to a public improvement district and/or other sources of revenue including the sale of District bonds.

NOTE 9. RISK MANAGEMENT

The District is exposed to various risks of loss related to torts, theft of, damage to and destruction of assets, error and omission and natural disasters for which the District carries commercial insurance. There have been no significant reductions in coverage from the prior year and there have been no settlements of claims exceeding coverage in the last three years.

NOTE 10. REIMBURSEMENT AGREEMENT

Effective May 20, 2009, the District entered into a reimbursement agreement between Castle Hills Development Corporation Bright Realty, Ltd., Bright Farm Partnership, Bright & Company, Inc., Castle Hills Property Company (collectively Bright Entities), District No. 1-A, District No, 1-C, District No. 1-D, District No. 1-E, District No, 1-F, District No. 1-G and the District (collectively the Districts). For advances made by Bright Entities on or before November 20, 2006, the Districts will reimburse the relevant Bright Entity for 100% of such advances.

**DENTON COUNTY FRESH WATER SUPPLY DISTRICT NO. 1-H
NOTES TO BASIC FINANCIAL STATEMENTS**

NOTE 10. REIMBURSEMENT AGREEMENT – CONTINUED

For advances made by a Bright Entity after November 20, 2006, the Districts will transfer reimbursement funds to District No. 1-A. District No. 1-A will act as a clearinghouse for receipt of reimbursement proceeds and for the deployment of such proceeds to any District that would otherwise require an advance from a Bright Entity. Any reimbursement for advances received by District No. 1-A will be considered as a full complete release of that particular District's obligation pursuant to existing developer reimbursement agreements.

NOTE 11. DUE TO DISTRICT OTHER GOVERNMENTAL UNITS

The District has recorded a liability in the amount of \$81,251 for its share of constructions costs related to Windhaven West, \$132,949 for engineering related to the Kingdom and \$91,349 for general operations of District No. 1-A. In addition, the District has recorded a liability of \$54,737 for developer advances due to District No. 1-A in accordance with the agreement noted in Note 10. The total amount due to District No. 1-A of \$360,286 has been recorded as a liability in the statement of net assets of the District.

The remaining balance of \$860,261 is due to various Districts as a result of the District's negative claim on pooled cash. This has been recognized as a liability on the governmental balance sheet since cash shortfalls are anticipated to be repaid within one year.

NOTE 12. BOND ELECTION

On November 4, 2008, voters within the District approved for the District to issue bonds in the maximum amount of \$54,000,000 for utilities and \$13,900,000 for roads. In addition, refunding bonds were approved in the amount of \$67,500,000 and road refunding bonds were approved in the amount of \$17,375,000.

NOTE 13. LITIGATION

On December 21, 2009, petitions for appeal of retail water and sewer rates of Denton County Fresh Water Supply District Nos. 1-A, 1-B, 1-C, 1-D, 1-E, 1-F, 1-G, and 1-H were submitted to the Texas Commission on Environmental Quality (TCEQ) under § 13.043(b)(4) of the Texas Water Code. The petition was filed at the TCEQ by Patrick Kelly on behalf of all petitioning ratepayers, appealing the decision of the Board of Directors of the named Districts. Under the Operating Agreements that the other named Districts have with District No. 1-A, District No. 1-A performs a variety of administrative services necessary to operate the Districts' facilities which includes defending all claims, administrative proceedings and lawsuits brought by third parties against the Districts which have any effect on the Districts' facilities, or the construction, maintenance or operation of the Districts' facilities.

**DENTON COUNTY FRESH WATER SUPPLY DISTRICT NO. 1-H
NOTES TO BASIC FINANCIAL STATEMENTS**

NOTE 13. LITIGATION – CONTINUED

Pursuant to the Operating Agreement and on behalf of all of the above-listed entities, Denton County Fresh Water Supply District No. 1-A filed a response to the petitions asserting that TCEQ does not have appellate jurisdiction over all or some of the listed water districts' rates. On June 14, 2010, an Administrative Law Judge (ALJ) for the State Office of Administrative Hearings (SOAH) accepted provisional jurisdiction over the rate appeal petitions subject to briefing by the Parties on certain jurisdictional issues. Such briefing to date has not been submitted due to on-going settlement discussions.

On July 23, 2010 a settlement agreement was entered into between District 1-A and the ratepayer petitioners of Districts 1-B, 1-C, 1-D, 1-E, 1-F, 1-G and 1-H as represented by Patrick Kelly. The settlement agreement calls for an independent review of water rates during the 2010-2011 fiscal year. The only remaining party which has not agreed to settle is an individual ratepayer of District 1-D. At the present time, the judge has not acted on District 1-A's request to dismiss the settling ratepayers and districts from the case and the case remains pending before the ALJ with a prehearing conference scheduled for April 7, 2011. It is anticipated that this rate appeal case will not be concluded prior to the beginning of fiscal year 2011-2012. If settlement discussions do not resolve the remaining rate appeal, an administrative hearing will be held after which TCEQ will determine the appropriate water and sewer rates for one or more of the above-listed water districts (depending upon the ALJ's ruling on jurisdictional issues). Such TCEQ-determined rates could be less than rates set by the Boards of the respective water districts, which could necessitate the issuance of refunds to customers and the future generation of revenues less than the amount budgeted by the affected water districts. At this time, no reasonable basis exists for determining whether that may occur or the impacts on the revenues of any of the water districts.

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REQUIRED SUPPLEMENTARY INFORMATION

**DENTON COUNTY FRESH WATER SUPPLY DISTRICT NO. 1-H
SCHEDULE OF REVENUES, EXPENDITURES AND CHANGES
IN FUND BALANCE - BUDGET AND ACTUAL - GENERAL FUND
FOR THE YEAR ENDED SEPTEMBER 30, 2010**

	<u>Budget Original</u>	<u>Budget Amended</u>	<u>Actual</u>	<u>Variance Positive (Negative)</u>
REVENUES				
Water service	\$ -	\$ -	\$ 1,168	\$ 1,168
Wastewater service	-	-	123	123
Penalty and interest	-	-	3	3
Permits and inspections	1,429	1,429	2,429	1,000
Sales tax revenues	-	-	4,749	4,749
Total revenues	<u>1,429</u>	<u>1,429</u>	<u>8,472</u>	<u>7,043</u>
EXPENDITURES/EXPENSES				
Service operations:				
Personnel	130	130	216	(86)
Professional fees	29,000	29,000	93,747	(64,747)
Contracted services	15,482	15,482	15,361	121
Purchased water service	34,495	34,495	33,628	867
Purchased wastewater service	10,184	10,184	14,642	(4,458)
Purchased non-potable water service	6,774	6,774	6,741	33
Utilities	4,031	4,031	3,975	56
Repairs and maintenance	18,007	18,007	16,629	1,378
Other	25,139	25,139	14,830	10,309
Total expenditures/expenses	<u>143,242</u>	<u>143,242</u>	<u>199,769</u>	<u>(56,527)</u>
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	<u>(141,813)</u>	<u>(141,813)</u>	<u>(191,297)</u>	<u>63,570</u>
OTHER FINANCING SOURCES (USES)				
Transfer out	-	-	(24,161)	(24,161)
Total other financing sources (uses)	<u>-</u>	<u>-</u>	<u>(24,161)</u>	<u>(24,161)</u>
NET CHANGE IN FUND BALANCES	(141,813)	(141,813)	(215,458)	39,409
FUND BALANCES AT OCTOBER 1, 2009	<u>(664,799)</u>	<u>(664,799)</u>	<u>(664,799)</u>	<u>-</u>
FUND BALANCES AT SEPTEMBER 30, 2010	<u><u>\$ (806,612)</u></u>	<u><u>\$ (806,612)</u></u>	<u><u>\$ (880,257)</u></u>	<u><u>\$ 39,409</u></u>

**SUPPLEMENTARY INFORMATION - REQUIRED BY
THE WATER DISTRICT FINANCIAL MANAGEMENT GUIDE**

**DENTON COUNTY FRESH WATER SUPPLY DISTRICT NO. 1-H
SERVICES AND RATES
FOR THE YEAR ENDED SEPTEMBER 30, 2010**

1. SERVICES PROVIDED BY THE DISTRICT DURING THE FISCAL YEAR:

Services provided by the district during the fiscal year:

<u> X </u>	Retail Water	<u> </u>	Wholesale Water	<u> X </u>	Drainage
<u> X </u>	Retail Wastewater	<u> </u>	Wholesale Wastewater	<u> </u>	Irrigation
<u> X </u>	Parks/Recreation	<u> X </u>	Fire Protection	<u> </u>	Security
<u> X </u>	Solid Waste/Garbage	<u> X </u>	Flood Control	<u> X </u>	Roads
	Participates in joint venture, regional system and/or wastewater service (other than emergency interconnect)				
<u> X </u>	Other (specify): _____				

2. RETAIL SERVICE PROVIDERS

a. RETAIL RATES FOR A 1" METER (OR EQUIVALENT):

Based on the rate order approved September 22, 2009

	<u>Minimum Charge</u>	<u>Minimum Usage</u>	<u>Flat Rate Y/N</u>	<u>Rate per 1,000 Gallons over Minimum Usage</u>	<u>Usage Levels</u>
Water:	34.75	2,000	N	3.74	2,001 to 15,000
				4.24	15,001 to 25,000
				5.06	25,001 to 35,000
				6.06	35,001 to 45,000
				7.06	45,001 to 55,000
				8.06	55,001 and up
Wastewater:					
Residential	8.75		N	3.70	2,001 not to exceed 15,000 gallons
Residential	37.04		Y		New Customers
Commercial	8.75		N	3.70	2,001 and up
Surcharge:					
Solid waste/garbage	16.07		Y		
Commission					
Regulatory Assessments	.5% of actual water and sewer bill				

District employs winter averaging for wastewater usage? X Yes No

Total monthly charges per 10,000 gallons usage: Water: 64.67 Wastewater: \$37.04
Solid Waste: \$16.07

**DENTON COUNTY FRESH WATER SUPPLY DISTRICT NO. 1-H
SERVICES AND RATES
FOR THE YEAR ENDED SEPTEMBER 30, 2010**

2. RETAIL SERVICE PROVIDERS (Continued)

b. WATER AND WASTEWATER RETAIL CONNECTIONS: (Unaudited)

<u>Meter Size</u>	<u>Total Connections</u>	<u>Active Connections</u>	<u>ESFC Factor</u>	<u>Active ESFC's</u>
Unmetered			X 1.0	0
≤ 3/4"	3	3	X 1.0	3
1"			X 2.5	0
1 1/2"			X 5.0	0
2"			X 8.0	0
3"			X 15.0	0
4"			X 25.0	0
6"			X 50.0	0
8"			X 80.0	0
10"			X 115.0	0
Total water connections	3	3		3
Total wastewater connections	2	2	X 1.0	2

3. TOTAL WATER CONSUMPTION DURING THE FISCAL YEAR ROUNDED TO THE NEAREST THOUSAND: (Unaudited)

		Water Accountability Ratio: (Gallons billed and sold/Gallons pumped and purchased)
Gallons billed to customers:	85,000	93.4%
Gallons purchased:	91,000	<u>From Upper Trinity Regional Water District</u>

**DENTON COUNTY FRESH WATER SUPPLY DISTRICT NO. 1-H
SERVICES AND RATES
FOR THE YEAR ENDED SEPTEMBER 30, 2010**

4. STANDBY FEES (authorized only under TWC Section 49.231):

Does the District have Debt Service standby fees? Yes ___ No X

Does the District have Operation and Maintenance standby fees? Yes ___ No X

5. LOCATION OF DISTRICT:

Is the District located entirely within one county? Yes X No

County or Counties in which District is located:

Denton County, Texas

Is the District located within a city?

Entirely _____ Partly _____ Not at all X

Is the District located within a city's extra territorial jurisdiction (ETJ)?

Entirely X Partly _____ Not at all

ETJ's in which District is located:

City of Lewisville, Texas.

Are Board Members appointed by an office outside the District? Yes ___ No X

**DENTON COUNTY FRESH WATER SUPPLY DISTRICT NO. 1-H
GENERAL FUND EXPENDITURES
FOR THE YEAR ENDED SEPTEMBER 30, 2010**

Personnel (including benefits)	\$	<u>216</u>
Professional fees:		
Auditing		7,000
Engineering		32,598
Legal		<u>54,149</u>
Total professional fees		<u>93,747</u>
Purchased services for resale:		
Water service		33,628
Non-potable water service		6,741
Wastewater service		<u>14,642</u>
Total purchased services for resale		<u>55,011</u>
Contracted services:		
Police department		2,463
Fire protection and EMS		5,839
Management fee		6,997
Solid waste disposal		<u>62</u>
Total contracted services		<u>15,361</u>
Utilities and electricity		<u>3,975</u>
Repairs and maintenance		<u>16,629</u>

**DENTON COUNTY FRESH WATER SUPPLY DISTRICT NO. 1-H
GENERAL FUND EXPENDITURES – CONTINUED
FOR THE YEAR ENDED SEPTEMBER 30, 2010**

Other expenditures:

Director fees	3,450
Directors costs	852
Insurance	5,483
Supplies - postage	238
Office rental	1,875
Equipment rental	472
Supplies - small tools	172
Supplies - uniforms	18
Supplies - gas and oil	503
Other	<u>1,767</u>

Total other expenditures	<u>14,830</u>
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Total expenditures	<u><u>\$ 199,769</u></u>
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Number of persons employed by the District -0- Full-Time -0- Part-Time

(Note: The District is allocated a portion of personnel cost from Denton County Fresh Water Supply District No. 1-A in accordance with an Operating Agreement.)

**DENTON COUNTY FRESH WATER SUPPLY DISTRICT NO. 1-H
COMPARATIVE SCHEDULE OF REVENUES AND EXPENDITURES
GENERAL FUND – TWO YEARS**

	<u>Amounts</u>		<u>Percent of Total Revenues</u>	
	<u>2010</u>	<u>2009*</u>	<u>2010</u>	<u>2009</u>
REVENUES:				
Water service	\$ 1,168	\$ 726	13.7 %	55.2 %
Wastewater service	123	-	1.5	0.0
Penalty and interest	3	-	0.0	0.0
Permits and inspections	2,429	-	28.7	0.0
Franchise fees	-	585	0.0	44.5
Sales tax revenues	4,749	-	56.1	0.0
Miscellaneous revenues	-	4	0.0	0.3
Total revenues	<u>8,472</u>	<u>1,315</u>	<u>100.0 %</u>	<u>100.0 %</u>
EXPENDITURES/EXPENSES				
Service operations:				
Salaries	216	79,979	2.5 %	6082.1 %
Professional fees	93,747	44,978	1106.6	3420.4
Contracted services	15,361	95,021	181.3	7225.9
Purchased water service	33,628	220,131	396.9	16740.0
Purchased wastewater service	14,642	46,211	172.8	3514.1
Purchased non-potable water service	6,741	-	79.6	0.0
Utilities	3,975	22,649	46.9	1722.4
Repairs and maintenance	16,629	82,678	196.3	6287.3
Other	14,830	61,040	175.0	4641.8
Capital outlay	-	8,296	0.0	630.9
Total expenditures/expenses	<u>199,769</u>	<u>660,983</u>	<u>2357.9 %</u>	<u>50264.9 %</u>
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	<u>(191,297)</u>	<u>(659,668)</u>	<u>-2257.9 %</u>	<u>-50164.9 %</u>
OTHER FINANCING SOURCES (USES)				
Transfer out	(24,161)	-		
Contributions to other governmental units	-	(5,010)		
Total other financing sources (uses)	<u>(24,161)</u>	<u>(5,010)</u>		
NET CHANGE IN FUND BALANCES	(215,458)	(664,678)		
FUND BALANCES AS ADJUSTED, OCTOBER 1, 2009				
	<u>(664,799)</u>	<u>(121)</u>		
FUND BALANCES SEPTEMBER 30, 2010				
	<u>\$ (880,257)</u>	<u>\$ (664,799)</u>		
TOTAL ACTIVE RETAIL WATER CONNECTIONS				
	<u>3</u>	<u>3</u>		
TOTAL ACTIVE RETAIL WASTEWATER CONNECTIONS				
	<u>2</u>	<u>-</u>		

*First year audit

**DENTON COUNTY FRESH WATER SUPPLY DISTRICT NO. 1-H
BOARD MEMBERS, KEY PERSONNEL AND CONSULTANTS
SEPTEMBER 30, 2010**

District Mailing Address - Denton County Fresh Water Supply District No. 1-H
2540 King Arthur, Suite 220
Lewisville, TX 75056

District Telephone No. - (972) 899-4000

<u>Board Members</u>	<u>Term of Office (Elected or Appointed)</u>	<u>Fees of Office for the year ended September 30, 2010</u>	<u>Expense Reimbursements for the year ended September 30, 2010</u>	<u>Title</u>
Ralph Hunter	05/12	\$ 750	\$ 134	President
David Ahles	05/10	\$ 300	\$ 40	Vice
Michael Clarke	05/14	\$ 750	\$ 40	Treasurer/ Asst. Secretary
Corwin Snow	05/12	\$ 900	\$ 148	Secretary
John Lessner	05/12	\$ 750	\$ 64	Assistant Secretary

Note: No Director has any business or family relationships (as defined by the Texas Water Code) with major landowners in the District, with the District's developer or with any of the District's consultants.

Submission date of most recent District Registration Form (TWC Sections 36.054 and 49.054): May 27, 2010.

The limit on Fees of Office that a Director may receive during a fiscal year is \$7,200 as set by the Texas Water Code Section 49.060. On May 18, 2005, the District formally adopted a Resolution setting the limits for its Directors at \$3,500. Fees of office are the amounts actually paid to a Director during the District's current fiscal year.

**DENTON COUNTY FRESH WATER SUPPLY DISTRICT NO. 1-H
BOARD MEMBERS, KEY PERSONNEL AND CONSULTANTS
SEPTEMBER 30, 2010**

<u>Consultants</u>	<u>Date Hired</u>	<u>Fees for the year ended September 30, 2010</u>	<u>Title</u>
Kelly Hart & Hallman, LLP 201 Main Street, Suite 2500 Fort Worth, TX 76102	6/3/2008	\$ 54,149	Attorney
Pate Engineers, Inc. 8150 Brookriver Drive, Suite S-700 Dallas, Texas 75247	11/16/2009	\$ -	Project Engineer
Zane Miller 2540 King Arthur, Suite 220 Lewisville, TX 75056	9/18/2007	\$ -	Investment Officer
McCall Gibson Swedlund Barfoot PLLC Certified Public Accountants 13100 Wortham Center Drive, Suite 235 Houston, TX 77065-5610	11/15/2000	\$ 7,000	Auditor
Denton County Appraisal District 3911 Morse Denton, TX 76208	Legislative Action	\$ -	Property Tax Appraisals
TRC Engineers, Inc. 8140 Walnut Hill Lane, Suite 500 Dallas, TX 75231	7/15/2000	\$ 32,598	Engineer