McLENNAN COUNTY APPRAISAL DISTRICT

ANNUAL FINANCIAL REPORT

DECEMBER 31, 2016

McLENNAN COUNTY APPRAISAL DISTRICT

TABLE OF CONTENTS

DECEMBER 31, 2016

	Page Number
Independent Auditors' Report	1 – 3
Management's Discussion and Analysis	4 – 7
Basic Financial Statements:	
Statement of Net Position and Governmental Fund Balance Sheet	8
Statement of Activities and Governmental Fund Revenues, Expenditures and Changes in Fund Balance	9
Notes to Financial Statements	10 – 21
Required Supplementary Information:	
Schedule of Revenues, Expenditures and Changes in Fund Balance – Budget and Actual	22
Schedule of Changes in Net Pension Liability and Related Ratios	23
Texas County and District Retirement System – Schedule of Employer Contributions	24
Notes to Schedule of Employer Contributions	25
Compliance Section:	
Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*	26 – 27

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The McLennan County Appraisal District ("the District") was created by the 66th Legislature of the State of Texas under the provisions of Senate Bill 621 known as the Property Tax Code. Under this code, the District was established in McLennan County and is responsible for appraising all property within the county for ad valorem tax purposes. Each of the taxing units within the District are allocated a portion of the amount of the District's budget equal to the proportion that the total dollar amount of property taxes imposed in the District by the unit for the tax year bears to the sum of the total dollar amount of property taxes imposed by all taxing units participating in the District.

In evaluating how to define the entity, for financial reporting purposes, management has considered all potential component units. The decision to include a potential component unit in the reporting entity was made by applying the criteria set forth in GASB Codification. The basic, but not the only, criterion for including a potential component unit with the reporting entity is the governing body's ability to exercise oversight responsibility. The most significant manifestation of this ability is financial interdependency. Other manifestations of the ability to exercise oversight responsibility include, but are not limited to, the selection of governing accountability for fiscal matters. A second criterion used in evaluating potential component units is the scope of public service. Application of this criterion involves considering whether the activity benefits the government and/or its citizens, or whether the activity is conducted within the geographic boundaries of the government and is generally available to its citizens. A third criterion used to evaluate potential component units for inclusion exclusion from the reporting entity is the existence of special financing relationships, regardless of whether the government is able to exercise oversight responsibilities. Based upon the application of these criteria, no additional component units are included in defining the District's reporting entity.

Government-wide and Fund Financial Statements

The government-wide financial statements (i.e., the statement of net position and the statement of activities) report information on all of the nonfiduciary activities of the District. *Governmental activities* are supported by tax appraisal services and investment revenue.

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

The government-wide and fund financial statements are provided for the governmental fund of the District with a column for adjustments between the two statements.

Measurement Focus, Basis of Accounting and Financial Statement Presentation

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenue is recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Tax appraisal services are recognized as revenue in the year for which they are performed.

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

The District reports the following major governmental fund:

> The ***General Fund*** is the District's primary operating fund. It accounts for all financial resources of the government.

As a general rule, the effect of interfund activity has been eliminated from the government-wide financial statements.

Assets and Deferred Inflows of Resources, Liabilities and Deferred Inflows of Resources, and Net Position or Fund Balance

Cash and Investments

> Cash consists of demand deposit accounts. The investment policies of the District are governed by state statute. Management has followed a practice of investing in certificates of deposit.

Capital Assets

> Capital assets, which include property, plant and equipment, are reported in the governmental activities column in the government-wide financial statements. The District defines capital assets as assets with an initial, individual cost of more than $1,000 and an estimated useful life in excess of one year. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at their acquisition cost, which is the price that would be paid to acquire an asset with equivalent service potential at the acquisition date.
>
> The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets' lives are not capitalized.

Property, plant and equipment are depreciated using the straight-line method over the following useful lives:

Assets	Years
Buildings	20 - 50
Furniture	5 - 10
Equipment and software	5 - 10

Deferred Outflows/Inflows of Resources

In addition to assets, the statement of financial position and/or balance sheet will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, deferred outflows of resources, represents a consumption of net position that applies to a future period(s) and so will not be recognized as an outflow of resources (expense/expenditure) until then. The District has the following items that qualify for reporting in this category.

- Pension contributions after measurement date – These contributions are deferred and recognized in the following fiscal year.

- Difference in projected and actual earnings on pension assets – This difference is deferred and amortized over a closed five year period.

- Changes in actuarial assumptions - This difference is deferred and amortized over a closed five year period.

In addition to liabilities, the statement of financial position and/or balance sheet will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, deferred inflows of resources, represents an acquisition of net position that applies to a future period(s) and so will not be recognized as an inflow of resources (revenue) until that time. The District has only one type of item that qualifies for reporting in this category. The difference in expected and actual pension experience is deferred and recognized over the estimated average remaining lives of all members determined as of the measurement date.

Pensions

For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expenses, information about the Fiduciary Net Position of the Texas County and District Retirement System (TCDRS) and additions to/deductions from TCDRS's Fiduciary Net Position have been determined on the same basis as they are reported by TCDRS. For this purpose, plan contributions are legally due. Benefit payments and refunds are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

Fund Balance Classification

The governmental fund financial statements present fund balances based on classifications that comprise a hierarchy that is based primarily on the extent to which the District is bound to honor constraints on the specific purposes for which amounts in the respective governmental funds can be spent. The classifications used in the governmental fund financial statements are as follows:

- Nonspendable: This classification includes amounts that cannot be spent because they are either (a) not in spendable form or (b) are legally or contractually required to be maintained intact. Nonspendable items are not expected to be converted to cash or are not expected to be converted to cash within the next year.

- Restricted: This classification includes amounts for which constraints have been placed on the use of the resources either (a) externally imposed by creditors, grantors, contributors, or laws or regulations of other governments, or (b) imposed by law through constitutional provisions or enabling legislation.

- Committed: This classification includes amounts that can be used only for specific purposes pursuant to constraints imposed by resolution of the Board of Directors, the District's highest level of decision making authority. These amounts cannot be used for any other purpose unless the Board of Directors removes or changes the specified use by taking the same type of action that was employed when the funds were initially committed. This classification also includes contractual obligations to the extent that existing resources have been specifically committed for use in satisfying those contractual requirements.

- Assigned: This classification includes amounts that are constrained by the District's intent to be used for a specific purpose but are neither restricted nor committed. This intent can be expressed by the Board of Directors.

- Unassigned: This classification includes the residual fund balance for the General Fund. The unassigned classification also includes negative residual fund balance of any other governmental fund that cannot be eliminated by offsetting of assigned fund balance amounts.

When an expenditure is incurred for purposes for which both restricted and unrestricted fund balance is available, the District considers restricted funds to have been spent first. When an expenditure is incurred for which committed, assigned, or unassigned fund balances are available, the District considers amounts to have been spent first out of committed funds, then assigned funds, and finally unassigned funds.

Net Position

Net position represents the difference between assets and liabilities. Net investment in capital assets consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of any borrowing used for the acquisition, construction or improvements of those assets, and adding back unspent proceeds. Net position is reported as restricted when there are limitations imposed on their use either through the enabling legislations adopted by the District or through external restrictions imposed by creditors or laws or regulations of other governments.

Use of Estimates

The process of preparing financial statements in conformity with generally accepted accounting principles requires the use of estimates and assumptions regarding certain types of assets, liabilities, revenue and expenses. Accordingly, actual results may differ from estimated amounts.

2. DETAILED NOTES ON ALL FUNDS

Deposits and Cash Equivalents

Custodial Credit Risk. In the case of deposits, this is the risk that in the event of a bank failure, the District's deposits may not be returned to it. As of December 31, 2016, all of the District's deposit balances were covered by FDIC insurance and pledged governmental securities.

Interest Rate Risk. In accordance with its investment policy, the District manages its exposure to declines in fair market values by limiting the average dollar-weighted maturity of its portfolio to a maximum of 365 days.

Credit Risk. It is the District's policy, as defined in the Texas Public Funds Investment Act, to limit its investments to investment types with an investment quality rating not less than A or its equivalent by a nationally recognized statistical rating organization.

Capital Assets

Capital asset activity for the year ended December 31, 2016, was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
Government activities:				
Capital assets, being depreciated:				
Building	$ 1,466,455	$ -	$ -	$ 1,466,455
Furniture	209,416	-	-	209,416
Equipment and software	2,032,261	69,701	-	2,101,962
Total capital assets being depreciated	3,708,132	69,701	-	3,777,833
Less accumulated depreciation:				
Building	(205,303)	(29,329)	-	(234,632)
Furniture	(77,466)	(10,150)	-	(87,616)
Equipment and software	(1,815,581)	(80,087)	-	(1,895,668)
Total accumulated depreciation	(2,098,350)	(119,566)	-	(2,217,916)
Total capital assets, being depreciated, net	$ 1,590,009	$(49,865)	$ -	$ 1,559,917

Defined Benefit Pension Plan

Plan Description. The District participates in a nontraditional defined benefit pension plan in the statewide Texas County and District Retirement System ("TCDRS"). The Board of Trustees of TCDRS is responsible for the administration of the statewide agent, multiple-employer, public employee retirement system consisting of nontraditional defined benefit pension plans. TCDRS issues a publicly available comprehensive annual financial report (CAFR) that can be obtained at *www.tcdrs.org*.

All full and part-time non-temporary employees participate in the plan, regardless of the number of hours they work in a year. Employees in a temporary position are not eligible for membership.

Benefits Provided. TCDRS provides retirement, disability and survivor benefits for all eligible employees. Benefit terms are established by the TCDRS Act. The benefit terms may be amended as of January 1, each year, but must remain in conformity with the Act.

Members can retire at age 60 and above with 10 or more years of service, with 30 years of service regardless of age, or when the sum of their age and years of service equals 75 or more. Members are vested after eight years of service, but must leave their accumulated contributions in the plan to receive any employer-financed benefit. Members who withdraw their personal contributions in a lump sum are not entitled to any amounts contributed by their employer.

Benefit amounts are determined by the sum of the employee's contributions to the plan, with interest, and employer-financed monetary credits. The level of these monetary credits is adopted by the governing body of the employer within the actuarial constraints imposed by the TCDRS Act so that the resulting benefits can be expected to be adequately financed by the employer's commitment to contribute. At retirement, death or disability, the benefit is calculated by converting the sum of the employee's accumulated contributions and the employer-financed monetary credits to a monthly annuity using annuity purchase rates prescribed by the TCDRS Act. Updated annuity purchase rates will go into effect for post-2017 benefit accruals earned after 2017. Benefits accrued before 2018 will not be impacted by this update. This change was reflected in the 2015 actuarial valuation.

Employees covered by benefit terms

At the December 31, 2015 valuation and measurement date, the following employees were covered by the benefit terms:

Inactive employees or beneficiaries currently receiving benefits	34
Inactive employees entitled to but not yet receiving benefits	16
Active employees	39
	89

Contributions. The contribution rates for employees in TCDRS are either 4%, 5%, 6%, or 7% of employee gross earnings, as adopted by the employer's governing body. Participating employers are required to contribute at actuarially determined rates to ensure adequate funding for each employer's plan. Under the state law governing TCDRS, the contribution rate for each entity is determined annually by the actuary and approved by the TCDRS Board of Trustees. The replacement life entry age actuarial cost method is used in determining the contribution rate. The actuarially determined rate is the estimated amount necessary to fund benefits in an orderly manner for each participate over his or her career so that sufficient funds are accumulated by the time benefit payments begin, with an additional amount to finance any unfunded accrued liability.

Employees for the District were required to contribute 7% of their annual gross earnings during the fiscal year. The required contribution rates for the District was 12.04% in calendar year 2016. However, the District elected to use a rate of 13%. The District's contributions to TCDRS for the year ended December 31, 2016, were $267,626, which exceeded required contributions by $47,577.

Net Pension Liability. The District's Net Pension Liability (NPL) was measured as of December 31, 2015, and the Total Pension Liability (TPL) used to calculate the Net Pension Liability was determined by an actuarial valuation as of that date.

Actuarial Assumptions

The Total Pension Liability in the December 31, 2015, actuarial valuation was determined using the following actuarial assumptions:

Inflation	3.0% per year
Overall payroll growth	2.0% per year
Investment rate of return	8.0%, net of pension plan investment expense, including inflation

Mortality rates for active members, retirees, and beneficiaries were based on the following:

Depositing members	The RP-2000 Active Employee Mortality Table for males with a two-year set-forward and the RP-2000 Active Employee Mortality Table for females with a four-year setback, both projected to 2014 with scale AA and then projected with 110% of the MP-2014 Ultimate scale after that.
Service retirees, beneficiaries and non-depositing members	The RP-2000 Combined Mortality Table projected to 2014 with scale AA and then projected with 110% of the MP-2014 Ultimate scale after that, with one year set-forward for males and no age adjustment for females.
Disabled retirees	RP-2000 Disabled Mortality Table projected to 2014 with scale AA and then projected with 110% of the MP-2014 Ultimate scale after that, with no age adjustment for males and a two-year set-forward for females.

The actuarial assumptions that determined the total pension liability as of December 31, 2015, were based on the results of an actuarial experience study for the period January 1, 2009 through December 31, 2012, except for mortality assumptions. Mortality assumptions were updated for the 2015 valuation to reflect projected improvements.

The long-term expected rate of return on pension plan investments is 8.0%. The pension plan's policy in regard to the allocation of invested assets is established and may be amended by the TCDRS Board of Trustees. The application of the investment return assumption was changed for purposes of determining plan liabilities in the 2015 actuarial valuation. All plan liabilities are now valued using an 8% discount rate. Previously, some liabilities were valued using a 7% discount rate and others were valued using a 9% discount rate.

The long-term expected rate of return on TCDRS is determined by adding inflation to expected long-term real returns, and reflecting expected volatility and correlation. The capital market assumptions and information below are based on January 2016 information for a 7 to 10 year time horizon. The valuation assumption for long-term expected return is re-assessed at a minimum of every four years, and is set based on a 30-year time horizon; the most recent analysis was performed in 2013. The target allocation and best estimates of geometric real rates return for each major assets class are summarized in the following table:

Asset Class	Benchmark	Target Allocation (1)	Geometric Real Rate of Return (Expected minus Inflation) (2)
US Equities	Dow Jones U.S. Total Stock Market Index	14.50%	5.45%
Private Equity	Cambridge Associates Global Private Equity & Venture Capital Index (3)	14.00%	8.45%
Global Equities	MSCI World (net) Index	1.50%	5.75%
International Equities - Developed	MSCI World Ex USA (net)	10.00%	5.45%
International Equities - Emerging	MSCI World Ex USA (net)	8.00%	6.45%
Investment-Grade Bonds	Barclays Capital Aggregate Bond Index	3.00%	1.00%
High-Yield Bonds	Citigroup High-Yield Cash-Pay Capped Index	3.00%	5.10%
Opportunistic Credit	Citigroup High-Yield Cash-Pay Capped Index	2.00%	5.09%
Direct Lending	Citigroup High-Yield Cash-Pay Capped Index	5.00%	6.40%
Distressed Debt	Citigroup High-Yield Cash-Pay Capped Index	3.00%	8.10%
REIT Equities	67% FTSE NAREIT Equity REITs Index + 33% FRSE EPRA/NAREIT Global Real Estate Index	3.00%	4.00%
Master Limited Partnerships (MLPs)	Alerian MLP Index	3.00%	6.80%
Private Real Estate Partnerships	Cambridge Associates Real Estate Index (4)	5.00%	6.90%
Hedge Funds	Hedge Fund Research, Inc. (HFRI) Fund of Funds Composite Index	25.00%	5.25%

(1) *Target asset allocation adopted at the April 2016 TCDRS Board meeting.*
(2) *Geometric real rates of return in addition to assumed inflation of 1.6% per Cliffwater's 2016 capital market assumptions.*
(3) *Includes vintage years 2006-present of Quarter Pooled Horizon IRRs.*
(4) *Includes vintage years 2007-present of Quarter Pooled Horizon IRRs.*

Discount Rate

The discount rate used to measure the Total Pension Liability was 8.1%. The projection of cash flows used to determine the discount rate assumed that employee and employer contributions will be made at the rates specified in statue. Based on that assumption, the pension plan’s Fiduciary Net Position was projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the long-term expected rate of return on pension plan investments was applied to all period of projected benefit payments to determine the Total Pension Liability.

Changes in the Net Pension Liability

	Increase (Decrease)		
	Total Pension Liability (a)	Plan Fiduciary Net Position (b)	Net Pension Liability (a) - (b)
Balance at 12/31/2014	$ 10,675,921	$ 10,330,033	$ 345,888
Changes for the year:			
Service cost	243,275	-	243,275
Interest on total pension liability [1]	851,239	-	851,239
Effect of plan changes [2]	(37,806)	-	(37,806)
Effect of economic/demographic gains or losses	(38,866)	-	(38,866)
Effect of assumptions changes or inputs	115,195	-	115,195
Refund of contributions	(4,484)	(4,484)	-
Benefit payments	(656,394)	(656,394)	-
Administrative expenses	-	(7,314)	7,314
Member contributions	-	127,936	(127,936)
Net investment income	-	16,071	(16,071)
Employer contributions	-	267,281	(267,281)
Other [3]	-	10,796	(10,796)
Balance at 12/31/2015	$ 11,148,080	$ 10,083,925	$ 1,064,155

[1] *Reflects the change in the liability due to the time value of money. TCDRS does not charge fees or interest.*

[2] *Reflects new annuity purchase rates applicable to all TCDRS employers effective January 1, 2018.*

[3] *Relates to allocation of system-wide items.*

Sensitivity Analysis

The following presents the net pension liability of the County, calculated using the discount rate of 8.1%, as well as what the County's net pension liability would be if it were calculated using a discount rate that is 1-percentage-point lower (7.1%) or 1-percentage-higher (9.1%) than the current rate:

	1% Decrease 7.1%	Current Discount Rate 8.1%	1% Increase 9.1%
Total pension liability	$ 12,357,581	$ 11,148,080	$ 10,122,162
Fiduciary net position	10,083,925	10,083,925	10,083,925
Net pension liability/(asset)	$ 2,273,656	$ 1,064,155	$ 38,237

Pension Plan Fiduciary Net Position

Detailed information about the pension plan's Fiduciary Net Position is available in a separately-issued TCDRS financial report. The report may be obtained on the Internet at *www.tcdrs.org*.

Pension Expense and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions

For the year ended December 31, 2016, the County recognized pension expense of $253,506. At December 31, 2016, the County reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	Deferred Inflows of Resources	Deferred Outflows of Resources
Differences between expected and actual economic experience	$ 158,552	$ -
Changes in actuarial assumptions	-	92,157
Difference between projected and actual investment earnings	-	730,733
Contributions subsequent to the measurement date	-	267,625
Total	$ 158,552	$ 1,090,515

$267,625 reported as deferred outflows of resources related to pension resulting from contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability for the year ending December 31, 2017. Other amounts reported as deferred outflows and inflows of resources related to pensions will be recognized in pension expenses as follows:

Fiscal Year Ended December 31,	
2017	$ 161,853
2018	161,853
2019	161,853
2020	178,779
2021	-
Thereafter	-

Long-term Debt

Annual debt service requirements to maturity for the District's long-term debt are as follows:

Year Ending December 31,	Governmental Activities Principal		Interest	
2017	$	73,989	$	53,623
2018		77,355		50,256
2019		80,876		46,735
2020		84,556		43,055
2021		88,404		39,207
2022-2026		506,152		131,905
2027-2029		298,576		20,453
Total	$	1,209,908	$	385,234

Changes in Long-term Debt

Long-term debt activity for the year ended December 31, 2016 was as follows:

	Beginning Balance		Additions		Reductions		Ending Balance		Due Within One Year	
Governmental activities:										
Note on building/furniture	$	1,302,183	$	-	$	92,275	$	1,209,908	$	73,989
Net Pension Liability		345,889		985,724		267,458		1,064,155		-
Compensated absences		242,330		138,545		116,853		264,022		52,804
Total long-term liabilities	$	1,890,402	$	1,124,269	$	476,586	$	2,538,085	$	126,793

Litigation

On various occasions, the District can be either a defendant or co-defendant in lawsuits. While the District and legal counsel cannot predict the results of any litigation, it believes it has meritorious defenses to those actions, proceedings and claims.

The District is involved in 76 lawsuits as of year-end related to taxpayers challenging appraisal values on their properties. Although the District would not be directly liable for any potential judgements or settlements in these cases, in the event that adverse judgements are reached in these cases, the District could suffer the imposition of some attorney fees ranging from $2,500 to $135,000.

Related Party Transactions

For the year ended December 31, 2016, the District had two Board Members that were also executive officers of the District's depository financial institution. These two members also abstained from voting when the depository contract bid was being approved.

REQUIRED
SUPPLEMENTARY INFORMATION

COMPLIANCE SECTION

BASIC FINANCIAL STATEMENTS

MANAGEMENT'S DISCUSSION AND ANALYSIS