

ANNUAL FINANCIAL REPORT

of the

Lone Star Groundwater Conservation District

For the Year Ended
December 31, 2016

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Lone Star Groundwater Conservation District

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Independent Auditor's Report

To the Board of Directors of the
Lone Star Groundwater Conservation District
655 Conroe Park North Drive
Conroe, Texas 77303

Report on the Financial Statements

We have audited the accompanying financial statements of the business-type activities of the Lone Star Groundwater Conservation District (the "District"), as of and for the year ended December 31, 2016, and the related notes to the financial statements, which collectively comprise Lone Star Groundwater Conservation District's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion 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 from material misstatement.

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

accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of Lone Star Groundwater Conservation District, as of December 31, 2016, and the respective changes in financial position for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

Correction of an Error

As disclosed in Note 8, in the year ending December 31, 2016, the District restated its net position as of December 31, 2015 to correct an error. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis information on pages 7 - 12 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, 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.

Other Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise Lone Star Groundwater Conservation District's basic financial statements. The accompanying budgetary comparison schedule and Texas Supplementary Information on

pages 36 - 37 and 40 – 45, respectively, are presented for purposes of additional analysis and are not a required part of the basic financial statements.

These schedules have not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

Brooks Cardiel, PLLC

BrooksCardiel, PLLC
The Woodlands, Texas
April 7, 2017

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MANAGEMENT'S DISCUSSION AND ANALYSIS

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Lone Star Groundwater Conservation District

MANAGEMENT'S DISCUSSION AND ANALYSIS

For the Year Ended December 31, 2016

As management of the Lone Star Groundwater Conservation District (the "District"), we offer readers of the District's financial statements this narrative overview and analysis of the financial activities of the District for the fiscal year ended December 31, 2016.

FINANCIAL HIGHLIGHTS

- The assets of the District exceeded its liabilities (net position) at December 31, 2016 by \$2,151,258.
- The District's total net position decreased by \$778,621.
- At the end of the fiscal year unrestricted portion of net position was \$480,234 or 21% of total annual expenses.

OVERVIEW OF THE FINANCIAL STATEMENTS

Financial Statements

The District is designated as a special-purpose government engaged only in business-type activities consistent with GASB 34. Governments engaged only in business-type activities should present only the financial statements required for enterprise funds. As a result, the financial statements presented within this report consist of the enterprise fund financial statements (i.e., the Statement of Net Position, Statement of Revenues, Expenses, and Changes in Net Position, and Statement of Cash Flows). The District has one enterprise fund.

Enterprise Fund Types

Enterprise funds are used to account for activities that are similar to those often found in the private sector. For the District this covers all activities. The measurement focus is on determination of net income, financial position, and cash flows. Enterprise funds distinguish operating revenues and expenses from non-operating items. Operating revenues include charges for services. Operating expenses include costs of materials, contracts, personnel, and depreciation. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses. Enterprise fund types follow Generally Accepted Accounting Principles "GAAP" as prescribed by the Governmental Accounting Standards Board "GASB".

Lone Star Groundwater Conservation District

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

For the Year Ended December 31, 2016

Notes to Financial Statements

The notes to the financial statements provide additional information that is essential to a full understanding of the data provided in the financial statements. The notes can be found after the financial statements within this report.

Other Information

In addition to basic financial statements and accompanying notes, this report also presents certain other supplementary information. A budgetary comparison schedule for the general fund has been included as a part of the other supplementary information. Additionally, Texas Supplementary Information (TSI) has been included to comply with state reporting requirements.

DISTRICT FINANCIAL ANALYSIS

As noted earlier, net position over time, may serve as a useful indicator of a government's financial position. In the case of the District, assets exceeded liabilities by \$2,151,258 at the close of the most recent fiscal year.

An important portion of the District's net position, assets, \$1,671,024, reflects its investments in capital assets (e.g., land, building, machinery, equipment, infrastructure, etc.), less any debt used to acquire those assets that is still outstanding. The District uses its capital assets, and a significant portion of its expenses, to develop, promote, and implement water conservation, augmentation, and management strategies to protect water resources for the benefit of the citizens of Montgomery County; consequently, these capital assets are not available for future spending.

Lone Star Groundwater Conservation District

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

For the Year Ended December 31, 2016

Statement of Net Position:

The following table reflects the condensed Statement of Net Position as of December 31:

	Business-Type Activities	
	(as Restated)	
	2016	2015
Current and other assets	\$ 1,346,703	\$ 1,970,651
Capital assets, net	1,671,024	1,723,897
Total Assets	3,017,727	3,694,548
Accounts payable & accrued expenses	151,894	148,935
Unearned revenue	714,575	615,734
Total Liabilities	866,469	764,669
Net position:		
Net investment in capital assets	1,671,024	1,723,897
Unrestricted	480,234	1,205,982
Total Net Position	\$ 2,151,258	\$ 2,929,879

Since its creation in 2001, the District has worked to develop a multi-phased regulatory plan designed to manage and protect groundwater resources within Montgomery County. To achieve this goal, a benchmark was established; to reduce groundwater pumped in 2016 by thirty percent (30%) of the total qualifying demand, based on 2009 permitted allocations. The District Regulatory Plan Phase II (B), effective 1/1/16, mandated that all large volume groundwater user's annual production be limited to seventy percent (70%) of their total qualifying demand, as determined through public hearings conducted by the District. As a result of this mandate, water use fees assessed by the District, decreased approximately \$606,788 from 2015 to 2016. This caused the District to use cash reserves to partially fund operations during 2016.

In addition to the reduction in water use fees, the District is defending its policies in two (2) ongoing lawsuits. During 2016, the District incurred \$568,053 in legal fees; \$301,736 which were incurred as a direct result of the lawsuits. During 2015, \$141,229 was spent in lawsuit litigation. Net position decreased \$778,621 in 2016 from 2015 as a result of reduced water use fees and increased legal expenses

Lone Star Groundwater Conservation District

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

For the Year Ended December 31, 2016

Statement of Revenues, Expenses, and Changes in Net Position:

The following table provides a summary of the District's changes in net position for the years ended December 31:

	Governmental Activities	
	2016	(as Restated) 2015
Revenues		
Water use fees	\$ 1,464,993	\$ 2,071,781
Interest and other	11,274	34,424
Total Revenues	1,476,267	2,106,205
Expenses		
Programs	364,986	378,091
Personnel	630,895	630,589
Legal	561,542	474,438
Education and public awareness	158,451	154,782
Other	472,169	478,690
Depreciation	66,845	87,191
Total Expenses	2,254,888	2,203,781
Change in Net Position	(778,621)	(97,576)
Beginning Net Position	2,929,879	3,027,455
Ending Net Position	\$ 2,151,258	\$ 2,929,879

Water use fees decreased by \$606,788 due to implementation of the District Regulatory Plan (DRP) Phase II (B), effective 1/1/16. Water use fees in 2015 were based on total authorized annual pumpage for each permit, including amendments. The total authorized pumpage for 2015 was 33,607,731,946. Water use fees in 2016 were based on the thirty percent (30%) reduction mandated by the DRP, referred to as the Initial Conservation Obligation (ICO). The 2016 ICO allocation was 23,525,412,362. This resulted in a reduction of 10,082,319,584 gallons.

Legal expenses increased due to current litigation and related matters; see Note 5.

Lone Star Groundwater Conservation District

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

For the Year Ended December 31, 2016

BUDGETARY HIGHLIGHTS

Actual revenues were less than final budgeted revenues by \$40,301 during the year. Water use fees were under budgeted amounts by \$43,770. Actual expenses were over the final budget by \$117,480. The most significant expense groupings over budget were legal and rebate on water use fees for \$238,053, and \$46,576, respectively. The net variance was a negative variance of \$157,781.

CAPITAL ASSETS

As of the end of the year, the District had invested \$1,671,024 in a variety of capital assets and infrastructure, net of accumulated depreciation.

Major capital asset acquisitions during the current year include the following:

- Purchase of an indoor water conservation exhibit for \$8,200
- Purchase of a water well exhibit for \$5,770

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

The District's appointed officials are responsive to the District's declining net position. In an effort to impede the decline in net position, the District raised water use fees in 2017, from \$0.06 per 1,000 gallons to \$0.075 per 1,000 gallons. The increase was effective for all permits, except alternative water source permits. The rate increase is expected to generate additional water use fees of \$304,885.

Total budgeted revenue is \$1,695,847, which includes \$41,850 in administrative fees. Total budgeted expense is \$2,311,207; which results in a projected net loss of \$615,360. This will result in a deficit for the third year since 2015.

The district officials and staff remain committed to the District plan to ensure a sustainable, adequate, high quality and cost effective water supply, now, and in the future.

The original calendar year 2017 budget was presented and adopted by the Board on December 15, 2016. The 2017 budget was amended and adopted on March 14, 2017.

Lone Star Groundwater Conservation District

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

For the Year Ended December 31, 2016

CONTACTING THE DISTRICT'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, customers, and creditors with a general overview of the District's finances to show the District's accountability for the money it receives. If you have any questions about this report or need additional financial information, contact the General Manager at 655 Conroe Park North Drive, Conroe, TX 77303.

FINANCIAL STATEMENTS

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Lone Star Groundwater Conservation District

STATEMENT OF NET POSITION

December 31, 2016

<u>Assets</u>	<u>Business-Type Activities</u>
Current Assets	
Cash	\$ 1,221,230
Receivables, net	113,644
Prepaid expenses	11,829
Total Current Assets	<u>\$ 1,346,703</u>
Noncurrent Assets	
Capital assets, non-depreciable	260,187
Capital assets (net of accumulated depreciation)	1,410,837
Total Assets	<u>\$ 3,017,727</u>
Liabilities	
Current Liabilities	
Accounts payable and accrued expenses	\$ 151,894
Unearned revenue	714,575
Total Current Liabilities	<u>866,469</u>
Net Position	
Net investment in capital assets	1,671,024
Unrestricted	480,234
Net Position	<u>\$ 2,151,258</u>

See Notes to Financial Statements.

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Lone Star Groundwater Conservation District

STATEMENT OF REVENUES, EXPENSES,
AND CHANGES IN NET POSITION
For the Year Ended December 31, 2016

	<u>Business-Type Activities</u>
Revenues	
Water use fees	\$ 1,384,798
Administrative use fees	16,047
Application fees	33,400
Overpumpage fees	30,748
Penalty & interest on fees	7,085
Other income	3,592
Export fees	597
Total Revenues	<u>1,476,267</u>
Expenses	
Programs	364,986
Personnel	630,895
Legal	561,542
Audit	9,531
Engineering	146,946
Education & public awareness	158,451
Board expenses	63,920
Rebate on water use fees	76,576
Manager expenses	18,999
Computer support	29,415
Office expenses	15,262
Supplies & other	9,415
Advertising & public notices	7,498
Travel and training staff	4,963
Membership dues	4,337
Building maintenance & utilities	56,045
Vehicle costs	4,365
Insurance	9,349
Miscellaneous	9,037
Depreciation	66,845
Interest	6,511
Total Expenses	<u>2,254,888</u>
Excess (Deficiency) of Revenues Over (Under) Expenses	(778,621)
Beginning Net Position	<u>2,929,879</u>
Ending Net Position	<u>\$ 2,151,258</u>

See Notes to Financial Statements.

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Lone Star Groundwater Conservation District

STATEMENT OF CASH FLOWS

For the Year Ended December 31, 2016

	Business-Type Activities
<u>Cash Flows from Operating Activities</u>	
Receipts from customers	\$ 1,466,565
Payments to employees	(718,888)
Payments to suppliers	(1,395,069)
Net Cash Provided by / (Used) in Operating Activities	(647,392)
 <u>Cash Flows from Capital and Related Financing Activities</u>	
Capital purchases	(13,972)
Net Cash Provided by / (Used) in Capital and Related Financing Activities	(13,972)
Net Increase / (Decrease) in Cash and Cash Equivalents	(661,364)
Beginning cash and cash equivalents	1,882,594
Ending Cash and Cash Equivalents	\$ 1,221,230
 <u>Reconciliation of Operating Income / (Loss) to Net Cash Provided by / (Used) in Operating Activities</u>	
Operating loss	\$ (778,621)
Adjustments to reconcile operating loss to net cash provided:	
Depreciation	66,845
Changes in Operating Assets and Liabilities:	
(Increase) Decrease in:	
Accounts receivable	(31,967)
Prepaid expenses	(5,449)
Increase (Decrease) in:	
Accounts payable and accrued liabilities	2,959
Unearned revenue	98,841
Net Cash Provided by / (Used) in Operating Activities	\$ (647,392)

See Notes to Financial Statements.

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Lone Star Groundwater Conservation District

NOTES TO FINANCIAL STATEMENTS

For the Year Ended December 31, 2016

NOTE 1 – CREATION OF DISTRICT

The Lone Star Groundwater Conservation District (District) was created by the 77th Legislature under the authority of Section 59, Article XVI, of the Texas Constitution and in accordance with Chapter 36 of the Texas Water Code to conserve, protect, and enhance the groundwater resources of Montgomery County, Texas.

The District was formed in 2001 and is governed by a board of directors who are appointed by various local government agencies and serve staggered four-year terms.

The mission of the District is to manage and protect the groundwater resources of Montgomery County, Texas and to work with others to ensure a sustainable, adequate, high quality and cost effective water supply for current and future needs.

The District is not a taxing authority. Operations of the District are funded by charges to water well users in the jurisdictions serviced by the District.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements and accounting policies of the District are prepared in conformity with generally accepted accounting principles for local governmental units as prescribed by the Governmental Accounting Standards Board, which is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The District's significant accounting policies are described below.

A. Reporting Entity

The District has adopted Governmental Accounting Standards Board Statement No. 14, *The Financial Reporting Entity*. In accordance with this statement, a financial reporting entity consists of the primary government, organizations for which the primary government is financially accountable, and other organizations for which the primary government is not accountable, but for which the nature and significance of their relationship with the primary government are such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete.

The District is governed by a Board of Directors consisting of nine individuals who are appointed by local governing bodies. As required by generally accepted accounting principles, these financial statements present the activities of the District, which is considered to be the primary government as well as the reporting entity. There are no other organizations which meet the criteria for inclusion herein as part of the financial reporting entity.

Lone Star Groundwater Conservation District

NOTES TO FINANCIAL STATEMENTS (Continued)

For the Year Ended December 31, 2016

B. Basis of presentation – financial statements

Since the District is not a taxing authority and earns all revenue through fees, no governmental funds exist for the District. The District is designated as a special-purpose government engaged only in business-type activities consistent with GASB 34. Governments engaged only in business-type activities should present only the financial statements required for enterprise funds. As a result, the financial statements presented within this report consist of the enterprise fund financial statements (i.e., the Statement of Net Position, Statement of Revenues, Expenses, and Changes in Net Position, and Statement of Cash Flows). The District has one enterprise fund.

C. Basis of presentation – fund financial statements

Enterprise Fund Types

Enterprise funds are used to account for activities that are similar to those often found in the private sector. For the District this covers all activities. The measurement focus is on determination of net income, financial position, and cash flows. Enterprise funds distinguish operating revenues and expenses from non-operating items. Operating revenues include charges for fees. Operating expenses include costs of materials, contracts, personnel, and depreciation. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses. Enterprise fund types follow GAAP prescribed by the Governmental Accounting Standards Board (GASB).

D. Measurement Focus and Basis of Accounting

The accounting and financial reporting treatment is determined by the applicable measurement focus and basis of accounting. Measurement focus indicates the type of resources being measured such as current financial resources or economic resources. The basis of accounting indicates the timing of transactions or events for recognition in the financial statements.

The accrual basis of accounting is used for the enterprise fund types. This basis of accounting recognizes revenues in the accounting period in which they are earned and become measurable, and expenses in the accounting period in which they are incurred and become measurable.

Lone Star Groundwater Conservation District

NOTES TO FINANCIAL STATEMENTS (Continued)

For the Year Ended December 31, 2016

E. Assets, liabilities, and net position

1. *Deposits and Investments*

The District's 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. For the purpose of the statement of cash flows, the proprietary fund types consider temporary investments with maturity of three months or less when purchased to be cash equivalents.

In accordance with GASB Statement No. 31, *Accounting and Reporting for Certain Investments and External Investment Pools*, the District reports all investments at fair value, except for "money market investments" and "2a7-like pools." Money market investments, which are short-term highly liquid debt instruments that may include U.S. Treasury and agency obligations, are reported at amortized costs. Investment positions in external investment pools that are operated in a manner consistent with the SEC's Rule 2a7 of the Investment Company Act of 1940, such as TexPool, are reported using the pools' share price.

The District has adopted a written investment policy regarding the investment of its funds as defined in the Public Funds Investment Act, Chapter 2256, of the Texas Governmental Code. In summary, the District is authorized to invest in the following:

- Direct obligations of the U.S. Government
- Fully collateralized certificates of deposit and money market accounts
- Statewide investment pools
- SEC registered, no load money market mutual funds

2. *Fair Value*

As of December 31, 2016, the District has applied Governmental Accounting Standards Board ("GASB") Statement No. 72, Fair Value Measurement and Application. GASB Statement No. 72 provides guidance for determining a fair value measurement for reporting purposes and applying fair value to certain investments and disclosures related to all fair value measurements.

3. *Receivables*

All trade receivables are shown net of any allowance for uncollectible amounts. The District estimates the allowance for doubtful accounts based on collections after the balance sheet date. As of December 31, 2016, the allowance for doubtful accounts was \$24,228.

Lone Star Groundwater Conservation District

NOTES TO FINANCIAL STATEMENTS (Continued)

For the Year Ended December 31, 2016

4. Capital Assets

Capital assets, which include property, plant, equipment, are defined by the government as assets with an initial individual cost of more than \$5,000 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 estimated fair market value at the date of donation. Major outlays for capital assets and improvements are capitalized as projects are constructed.

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 of the primary government are depreciated using the straight-line method over the following estimated useful years:

<u>Asset Description</u>	<u>Estimated Useful Life</u>
Buildings	40 years
Furniture, vehicles, and equipment	5 to 7 years

5. Prepaid expenses

Certain payments to vendors reflect costs applicable to future accounting periods (prepaid expenses) are recognized as expenses when utilized.

6. Deferred outflows/inflows of resources

In addition to assets, the statement of net position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, *deferred outflows of resources*, represents a consumption of net position that applies to a future period(s) and so will *not* be recognized as an outflow of resources (expense/ expenditure) until then.

In addition to liabilities, the statement of net position 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. This amount is deferred and recognized as an inflow of resources in the period that the amounts become available.

Lone Star Groundwater Conservation District

NOTES TO FINANCIAL STATEMENTS (Continued)

For the Year Ended December 31, 2016

7. *Net position flow assumption*

Sometimes the government will fund outlays for a particular purpose from both restricted (e.g., restricted bond or grant proceeds) and unrestricted resources. In order to calculate the amounts to report as restricted – net position and unrestricted net position in the financial statements, a flow assumption must be made about the order in which the resources are considered to be applied.

It is the government's policy to consider restricted – net position to have been depleted before unrestricted – net position is applied.

8. *Compensated absences*

The liability for compensated absences reported in the proprietary fund statements consist of unpaid, accumulated vacation and compensatory time balances. The liability has been calculated using the vesting method, in which leave amounts for both employees who currently are eligible to receive termination payments and other employees who are expected to become eligible in the future to receive such payments upon termination are included. Vested or accumulated vacation leave and compensated leave of proprietary funds are recognized as an expense and liability of those funds as the benefits accrue to employees.

The District's personnel policy grants its eligible employees vacation pay benefits in varying amounts to specified maximums depending on tenure with the District. District employees may carry forward into the subsequent year, with management approval, earned but unused vacation pay benefits up to specified maximums. Upon separation with the District, employees will be paid for their accrued and unused vacation pay benefits. At December 31, 2016, the accrued vacation pay benefit balance was \$7,437.

The District's personnel policy permits its eligible employees to accrue up to 160 hours of sick leave per year. Unused, accumulated sick leave may be carried forward into the subsequent year with management approval. Upon separation with the District, employees will not be paid for unused, accumulated sick leave.

9. *Estimates*

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

Lone Star Groundwater Conservation District

NOTES TO FINANCIAL STATEMENTS (Continued)

For the Year Ended December 31, 2016

10. Unearned revenue

Unearned revenue represents revenues billed but not earned as of December 31, 2016. This is comprised of revenue for well permits billed in the current year that relate to the annual or quarterly periods following December 31, 2016. The revenue is deferred and recognized in the permit year. As of December 31, 2016, unearned revenue was \$714,575.

NOTE 3 – STEWARDSHIP, COMPLIANCE, AND ACCOUNTABILITY

The original budget is adopted by the Board of Directors prior to the beginning of the year. Management may not amend the budget without the approval of the Board.

The District has adopted a non-appropriated budget in accordance with Title 30 of the Texas Administrative Code, Section 293.97. The budget is prepared using the modified accrual method of accounting. The budgetary comparison schedule is presented as other supplementary information to the basic financial statements.

NOTE 4 - DETAILED NOTES

A. Deposits and Investments

As of December 31, 2016, the District had the following investments:

<u>Investment Type</u>	<u>Fair Value</u>	<u>Maturity (years)</u>
Money market funds	\$ 948,985	-
External investment pools	265,664	0.11
	<u>\$ 1,214,649</u>	
Portfolio weighted average maturity		0.02

Interest rate risk. In accordance with its investment policy, the District manages its exposure to declines in fair values by limiting the weighted average of maturity not to exceed two years; structuring the investment portfolio so that securities mature to meet cash requirements for ongoing operations; monitoring credit ratings of portfolio position to assure compliance with rating requirements imposed by the Public Funds Investment Act; and invest operating funds primarily in short-term securities or similar government investment pools.

Lone Star Groundwater Conservation District

NOTES TO FINANCIAL STATEMENTS (Continued)

For the Year Ended December 31, 2016

Credit risk. The District's investment policy limits investments in money market mutual funds rated as to investment quality not less than AAA by Standard & Poor's. As of December 31, 2016, the District's investment in TexPool was rated AAAM by Standard & Poor's.

Custodial credit risk – deposits. 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. State statutes require that all deposits in financial institutions be insured or fully collateralized by U.S. government obligations or its agencies and instrumentalities or direct obligations of Texas or its agencies and instrumentalities that have a market value of not less than the principal amount of the deposits. As of December 31, 2016 the District's insurance plus pledged collateral covered all deposits.

Custodial credit risk – investments. For an investment, this is the risk that, in the event of the failure of the counterparty, the District will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The District's investment policy requires that it will seek to safekeeping securities at financial institutions, avoiding physical possession. Further, all trades, where applicable, are executed by delivery versus payment to ensure that securities are deposited in the District's safekeeping account prior to the release of funds.

TexPool

TexPool was established as a trust company with the Treasurer of the State of Texas as trustee, segregated from all other trustees, investments, and activities of the trust company. The State Comptroller of Public Accounts exercises oversight responsibility over TexPool. Oversight includes the ability to significantly influence operations, designation of management, and accountability for fiscal matters. Additionally, the State Comptroller has established an advisory board composed of both participants in TexPool and other persons who do not have a business relationship with TexPool. The advisory board members review the investment policy and management fee structure. Finally, Standard & Poor's rate TexPool AAAM. As a requirement to maintain the rating, weekly portfolio information must be submitted to Standard & Poor's, as well as to the office of the Comptroller of Public Accounts for review.

Lone Star Groundwater Conservation District

NOTES TO FINANCIAL STATEMENTS (Continued)

For the Year Ended December 31, 2016

B. Receivables

The following comprise the receivable balances at year end:

Type	Total
Permit receivables	\$ 137,872
Allowance for doubtful accounts	(24,228)
Total	\$ 113,644

C. Capital Assets

A summary of changes in capital assets for the year ended is as follows:

	Beginning Balances	Increases	Decreases/ Reclassifications	Ending Balances
Capital assets, not being depreciated:				
Land	\$ 260,187	\$ -	\$ -	\$ 260,187
Total capital assets not being depreciated	260,187	-	-	260,187
Capital assets, being depreciated:				
Building	1,593,553	-	-	1,593,553
Furniture, vehicles & equipment	241,075	13,972	-	255,047
Total capital assets being depreciated	1,834,628	13,972	-	1,848,600
Less accumulated depreciation				
Building	(189,380)	(38,976)	-	(228,356)
Furniture, vehicles & equipment	(181,538)	(27,869)	-	(209,407)
Total accumulated depreciation	(370,918)	(66,845)	-	(437,763)
Net capital assets being depreciated	1,463,710	(52,873)	-	1,410,837
Total capital assets	\$ 1,723,897	\$ (52,873)	\$ -	\$ 1,671,024

Depreciation expense was \$66,845 for the year ended December 31, 2016.

Lone Star Groundwater Conservation District

NOTES TO FINANCIAL STATEMENTS (Continued)

For the Year Ended December 31, 2016

C. Line of Credit

On December 22, 2016, the Organization entered into a \$500,000 line of credit with a bank. The line of credit matures on 12/22/17, and bears interest at a variable rate based on Prime. The line of credit is collateralized by the Organization's building.

As of December 31, 2016, the Organization hadn't made any draws on the line of credit, and therefore the balance outstanding was \$0. Fees of \$6,511 were incurred to establish the line of credit.

NOTE 5 – OTHER INFORMATION

A. The 401(a) - Money Purchase Plan (401a Plan)

The 401a Plan is an employer-sponsored deferred contribution plan established by the District to provide benefits at retirement for its employees. Participation in the 401a Plan is mandatory. 401a Plan participants are required to contribute 3% of their gross wages per year, not to exceed federal maximums. The District will match the employee's 3% contributions at a 2:1 ratio to a maximum of 6%. Any employee contribution greater than 3% will not be matched. Employer matching contributions vest according to the 401a Plan policy.

Unvested employer contributions will be used to pay administrative expenses of the 401a Plan, with any remainder being applied to reduce employer contributions. 401a Plan provisions and contribution requirements are established and may be amended by the District.

The assets of the 401a Plan are administered by ICMA Retirement Corporation. The District does not exercise any control over these assets.

District contributions to the 401a Plan for the year ended December 31, 2016 were \$16,725. Additional contributions from plan forfeitures were \$12,660.

Lone Star Groundwater Conservation District

NOTES TO FINANCIAL STATEMENTS (Continued)

For the Year Ended December 31, 2016

B. The 457 – Defined Contribution Plan (457 Plan)

The District also offers a defined contribution pension 457 Plan to its employees. Plans of deferred compensation described in Internal Revenue Code (IRC) section 457 are available to employees of certain state and local governments and non-governmental entities that are tax-exempt under IRC 501. As the District is a local government entity and is tax-exempt, the 457 Plan is a governmental eligible 457(b) plan. Plans eligible under 457(b) allow employees of sponsoring organizations to defer income taxation on retirement savings into future years. Employee participation in the District 457 Plan is optional. Employees contribute based on federal limits and guidelines. There is no District match. The Plan's assets are administered by ICMA Retirement Corporation. The District does not exercise any control over the plan assets.

In addition to its retirement plans, the District also makes contributions into the Social Security system. Effective January 1, 2000, the Internal Revenue Service determined that members of Boards of Directors are considered to be "employees" for federal payroll tax purposes only.

C. Risk Management

The District is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; and natural disasters for which the District carries insurance coverage. There have been no significant reductions in coverage from the prior year.

The District is presently defending the following pending litigation; Cause No. 15-08-08942; City of Conroe et al v. Lone Star Groundwater Conservation District et al; in the 284th Judicial District Court of Montgomery County, Texas. In the suit, in addition to seeking recovery of attorneys' fees and costs, the Plaintiffs allege that the Defendants' actions with regard to adoption of its District Regulatory Plan exceed their statutory authority and constitute takings of their property without just compensation, but neither identify the specific property nor the dollar amount of their claims. The District have vigorously contested and defended themselves against the lawsuit. If unsuccessful, at this early stage in the lawsuit, the District is unable to estimate the likelihood of an unfavorable outcome or estimated range of loss if an unfavorable outcome for the District were to occur.

NOTE 6 – COMMITMENTS

The District has entered into an agreement with Abstract Media to assist with website redesign to focus in and leverage more interactive functionality and stronger branding. The total cost of the contract is \$6,998; \$2,332 will be due in 2017 when the development is complete.

Lone Star Groundwater Conservation District

NOTES TO FINANCIAL STATEMENTS (Continued)

For the Year Ended December 31, 2016

The District has entered into an agreement with Comcast Spotlight for streaming video impressions and TV commercials. The agreement will lapse in June, 2017. As of December 31, 2016, \$10,000 was due on the agreement.

The District has entered into an agreement with Halff Associates, Inc. for hosting services for the on-line permitting and well resignation database. The annual cost of this service is \$10,000; and will cover the period 1/1/17 to 12/31/17.

The District has entered into an agreement with Asakura Robinson Company, Inc. for the preparation and submittal of a priced proposal to create an overall master design for renovations to the District's detention facility and adjacent grounds; referred to as the "Water Smart Master Plan". Professional services will be billed as data gathering, stakeholder engagement, and document production once services are completed. The contract amount is \$26,300; \$8,984 remains outstanding on the contract as of December 31, 2016.

The District leases a copier from De Lage Landen Financial Service, Inc. under 36 month lease term. The lease expires on 10/29/17. Ten monthly payments of \$293 remain outstanding on the lease as of December 31, 2016.

Near the end of 2014, the District's board of directors embarked on an updated Strategic Water Resources Plan (the "Strategic Plan") to serve as a guide in the conservation and management of groundwater resources in Montgomery County. This Strategic Plan is designed to evaluate potential opportunities for the additional development of groundwater resources, while ensuring the long-term viability of aquifers located in Montgomery County.

This plan has three parts:

- 1) To study groundwater production and water-level data assessment
- 2) To review the Total Estimated Recoverable Storage (TERS)
- 3) To determine future groundwater availability

The scope of this part has been extended and expanded to improve the predictions that are developed. The study began near the end of 2014, and was expected to take 2-3 years to complete. Approximately \$160,000 is outstanding on this contract as of December 31, 2016.

On November 10, 2016, the District authorized a \$288,000 joint funding agreement for data collection with the U.S. Geological Survey (USGS) for calendar year 2017. The agreement covers three areas:

- 1) Ground Water Program: This program is responsible for (1) the inventory of select wells that can be incorporated into the ground-water network, (2) collection of ground-water quality data in the Houston area, and (3) provide an annual report of water-level and water-quality data.

Lone Star Groundwater Conservation District

NOTES TO FINANCIAL STATEMENTS (Continued)

For the Year Ended December 31, 2016

2) Water-level Monitoring Network: This program is responsible for (1) measure static ground-water levels in active Gulf Coast aquifer wells during the winter in Montgomery and adjacent counties, (2) prepare a report of water-level altitudes and altitude changes in the Gulf Coast Aquifer System for the current year, and (3) measure pumping ground-water levels in active Gulf Coast aquifer wells during the summer in Montgomery and adjacent counties.

3) Catahoula Water Chemistry Network: The objective of this study is to assess quality and determine the “chemical fingerprint” of the water from the Catahoula Sandstone from selected wells screened in the Catahoula Sandstone in Montgomery County area.

The District will contribute \$231,375 to the joint funding agreement, and the USGS will contribute \$56,625. The District participated in a similar agreement during 2016; with a contract amount of \$251,375.

NOTE 7 – RELATED PARTY

District board member, Mr. Wood, is also a board member with First Financial Bank, which holds the majority of the District’s deposits and has issued a line of credit for the District. Mr. Wood abstains from voting on matters related to First Financial Bank.

NOTE 8 - RESTATEMENT

The District has restated its beginning net position due to a difference in accrued expenses and program expenses applicable to the prior year. The restatement of beginning net position is as follows:

	Business Type
	Activities
Prior year ending net position	\$ 2,972,724
Increase in accrued expenses	(42,845)
Restated net position	<u>\$ 2,929,879</u>

NOTE 9 – SUBSEQUENT EVENTS

The District evaluated subsequent events through April 7, 2017, the date the financial statements were available to be issued.

Lone Star Groundwater Conservation District

NOTES TO FINANCIAL STATEMENTS (Continued)

For the Year Ended December 31, 2016

On January 27, 2017 the District entered into an inter-local contract with the State Office Administrative Hearings (SOAH). SOAH shall conduct a hearing for the District on a contested case hearing regarding the petitions for appeal of desired future conditions (DFCs) by three (3) petitioners. The DFCs define acceptable levels of drawdown for each subdivision of the aquifer underlying Montgomery County. The District expects to incur additional legal expenses in 2017 relating to this hearing, however, the nature of the appeal will not result in financial loss to the District.

NOTE 10 – NEW ACCOUNTING PRONOUNCEMENTS

The Governmental Accounting Standards Board (GASB) has issued several new pronouncements. The District has reviewed these new pronouncements and has determined that, at this time, they do not appear to be applicable to the District.

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OTHER SUPPLEMENTARY INFORMATION

Lone Star Groundwater Conservation District

BUDGETARY COMPARISON - PROPRIETARY FUND (Page 1 of 2)

For the Year ended December 31, 2016

	Original Budget Amounts	Final Budget Amounts	Actual	Variance Positive (Negative)
Revenues				
Water use fees	\$ 1,428,568	\$ 1,428,568	\$ 1,384,798	\$ (43,770)
Administrative use fees	11,700	11,700	16,047	4,347
Application fees	39,300	39,300	33,400	(5,900)
Overpumpage fees	15,000	15,000	30,748	15,748
Penalty & interest on fees	15,000	15,000	7,085	(7,915)
Other income	4,000	4,000	3,592	(408)
Export fees	3,000	3,000	597	(2,403)
Total Revenues	1,516,568	1,516,568	1,476,267	(40,301)
Expenses				
Programs	419,075	419,075	364,986	54,089
Personnel	740,802	665,551	630,895	34,656
Legal	330,000	330,000	561,542	(231,542)
Audit	8,000	8,000	9,531	(1,531)
Engineering	212,500	192,500	146,946	45,554
Education & public awareness	209,857	199,357	158,451	40,906
Board expenses	88,000	66,500	63,920	2,580
Rebate on water use fees	30,000	30,000	76,576	(46,576)
Manager expenses	22,000	20,000	18,999	1,001
Computer support	35,000	35,000	29,415	5,585
Office expenses	17,000	17,000	15,262	1,738
Supplies & other	13,250	13,250	9,415	3,835
Advertising & public notices	10,000	9,000	7,498	1,502

Lone Star Groundwater Conservation District

BUDGETARY COMPARISON - PROPRIETARY FUND (Page 2 of 2)

For the Year ended December 31, 2016

	Original Budget Amounts	Final Budget Amounts	Actual	Variance Positive (Negative)
Expenses (continued)				
Travel and training staff	10,000	8,000	4,963	3,037
Membership dues	5,000	5,000	4,337	663
Building maintenance & utilities	45,000	41,500	56,045	(14,545)
Vehicle costs	11,500	10,500	4,365	6,135
Insurance	11,300	11,300	9,349	1,951
Miscellaneous	3,000	3,000	9,037	(6,037)
Capital outlay - other	-	-	13,972 ¹	(13,972)
Interest	-	-	6,511	(6,511)
Total Expenses	\$ 2,221,284	\$ 2,084,533	\$ 2,202,015	\$ (117,482)
Revenues over (under) expenses	\$ (704,716)	\$ (567,965)	\$ (725,748)	\$ (157,783)
Beginning Net Position			2,929,879	
Ending Net Position - modified			\$ 2,204,131 ¹	
Capital outlay			13,972	
Depreciation expense			(66,845)	
Ending Net Position			\$ 2,151,258	

¹ Budget presented on modified accrual basis.

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TEXAS SUPPLEMENTARY INFORMATION

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Lone Star Groundwater Conservation District

SERVICE TYPE

For the Year Ended December 31, 2016

1. **Services provided by the District:**

<input type="checkbox"/>	Retail Water	<input type="checkbox"/>	Wholesale Water	<input type="checkbox"/>	Drainage
<input type="checkbox"/>	Retail Sewer	<input type="checkbox"/>	Wholesale Sewer	<input type="checkbox"/>	Irrigation
<input type="checkbox"/>	Parks/Recreation	<input type="checkbox"/>	Fire Protection	<input type="checkbox"/>	Security
<input type="checkbox"/>	Solid Waste/Garbage	<input type="checkbox"/>	Flood Control	<input type="checkbox"/>	Roads
<input type="checkbox"/>	Participates in joint venture, regional system and/or wastewater service (other than emergency interconnect)				
<input checked="" type="checkbox"/>	Other (specify):	<u>Water conservation services</u>			

Lone Star Groundwater Conservation District
COMPARATIVE SCHEDULE OF REVENUES AND EXPENDITURES
Last Five Years

	Amounts				
	2016	2015	2014	2013	2012
Revenues					
Application fees	\$ 33,400	\$ 34,850	\$ 44,460	\$ 42,939	35,197
Export fees	597	1,765	2,942	18,842	10,193
Water use fees	1,400,845	2,020,219	1,964,785	1,895,988	1,841,087
Interest income	3,542	4,657	5,096	6,744	8,683
Overpumpage fee	30,748	16,712	7,296	27,534	76,680
Miscellaneous	50	11,372	11,560	2,401	2,248
Penalty & interest	7,085	16,630	1,930	14,351	35,954
Total Revenues	1,476,267	2,106,205	2,038,069	2,008,799	2,010,042
Total Expenses	2,254,888	2,203,781	1,902,987	1,668,815	1,810,071
Revenues Over					
(Under) Expenditures	\$ (778,621)	\$ (97,576)	\$ 135,082	\$ 339,984	\$ 199,971

Percent of Total Fund Revenues

2016	2015	2014	2013	2012
2.3 %	1.7 %	2.2 %	2.1 %	2.3 %
0.0 %	0.1 %	0.1 %	0.9 %	0.0 %
94.9 %	95.9 %	96.4 %	94.4 %	94.9 %
0.2 %	0.2 %	0.3 %	0.3 %	0.2 %
2.1 %	0.8 %	0.4 %	1.4 %	2.1 %
0.0 %	0.5 %	0.6 %	0.1 %	0.0 %
0.5 %	0.8 %	0.1 %	0.7 %	0.5 %
<u>100.0 %</u>	<u>100.0 %</u>	<u>100.0 %</u>	<u>100.0 %</u>	<u>100.0 %</u>
<u>152.7 %</u>	<u>104.6 %</u>	<u>93.4 %</u>	<u>83.1 %</u>	<u>152.7 %</u>
<u>(52.7) %</u>	<u>(4.6) %</u>	<u>6.6 %</u>	<u>16.9 %</u>	<u>9.9 %</u>

Lone Star Groundwater Conservation District

PROPRIETARY FUND EXPENDITURES

For the Years Ended December 31, 2016 and 2015

	2016	2015
<u>Current</u>		
Personnel Services (including benefits)	\$ 630,895	\$ 630,589
Professional Fees:		
Auditing	9,531	8,000
Legal	561,542	474,438
Consulting	146,946	146,970
	718,019	629,408
 Administrative programs		
Directors' fees	55,709	63,094
Office supplies & Postage	9,415	11,479
Insurance	9,349	9,122
	74,473	83,695
 Community programs		
Well spacing	-	1,688
Hydrogeological modeling	600	2,655
Strategic planning & other	113,011	142,373
USGS - joint funding agreement	251,375	188,530
	364,986	335,246
 Other Expenditures		
Building expense, including depreciation	95,023	108,793
Depreciation on equipment	27,867	30,657
Education & public awareness	158,451	154,782
Travel/training for staff & board	32,173	40,670
Computer support	29,415	30,604
Advertising	7,498	7,525
Membership dues & subscriptions	4,337	4,264
User fees rebates	76,576	77,526
Miscellaneous & other expenses	24,299	18,116
Field & technical	4,365	9,061
	460,004	481,998
Total Expenditures	\$ 2,248,377	\$ 2,160,936
	(6,511)	

Lone Star Groundwater Conservation District

CASH AND TEMPORARY INVESTMENTS

December 31, 2016

<u>Funds</u>	<u>Identification or Certificate Number</u>	<u>Interest Rate (%)</u>	<u>Maturity Date</u>	<u>Balance</u>
Checking - operating	1049725	0.00%	N/A	\$ 6,582
Checking - money market	1026172	0.40%	N/A	948,985
TexPool	788420	0.48%	N/A	<u>265,664</u>
	Total			<u><u>\$ 1,221,230</u></u>

Lone Star Groundwater Conservation District

BOARD MEMBERS, KEY PERSONNEL AND CONSULTANTS

For the Year Ending December 31, 2016

District's Mailing Address:

655 Conroe Park North Drive
Conroe, Texas 77303

District's Business Telephone Number:

(936) 494-3436

<u>Board Members</u>	<u>Term Expires</u>	<u>Fees</u>	<u>Expenses</u>	<u>Title</u>
1 Richard J. Tramm	1/31/2017	\$ 8,250	\$ -	President
James M. Stinson	1/31/2019	\$ 6,500	\$ -	Vice President
Rick J. Moffat	1/31/2019	\$ 9,000	\$ -	Secretary
2 W.B. Wood	1/31/2019	\$ 9,000	\$ 75	Treasurer
John Bleyl, PE	1/31/2017	\$ 6,250	\$ -	Director
Gregg Hope	1/31/2019	\$ 6,500	\$ -	Director
Jace A. Houston	1/31/2017	\$ 4,250	\$ -	Director
Roy McCoy, Jr.	1/31/2019	\$ 2,000	\$ -	Director
M. Scott Weisinger, PG	1/31/2017	\$ -	\$ -	Director

1 Mr. Tramm was not re-appointed and was replaced by Webb Melder as a Director.

2 Mr. Wood is a board member with First Financial Bank, which holds some of the District's deposits and has issued a line of credit for the District. Mr. Wood abstains from voting on matters related to First Financial Bank.

<u>Name and Address</u>		<u>Amount</u>	<u>Title</u>
<u>Key Administrative Personnel</u>			
Kathy Turner Jones	Salary	\$ 130,811	General Manager
	Expenses	\$ 14,440	
Paul R. Nelson (Part time)	Salary	\$ 48,096	Asst. G.M.
	Expenses	\$ 3,844	
<u>Consultants</u>			
Sledge Law & Public Strategies		\$ 311,459	Legal
Martin Earl & Stilwell, LLP		\$ 102,812	Legal
Graves Dougherty Hearon & Moody		\$ 63,977	Legal
Smith, Robertson, Elliott & Douglas, LLP		\$ 44,963	Legal
Law Office of Jo Miller		\$ 31,184	Legal
Fowler Law Firm		\$ 15,350	Legal
John Choate		\$ 3,824	Legal
KSS Resolutions, LLC		\$ 240	Legal
Department of Interior - USGS		\$ 231,375	Research & development
Half Associates		\$ 105,698	Engineering
LBG-Guyton Associates		\$ 97,619	Engineering
Mark Lowry, PE		\$ 31,795	Engineering
Intra		\$ 18,022	Engineering
Mullican and Associates		\$ 32,475	Consultant
MCB Technologies		\$ 15,371	Consultant
Powers Mediaworks, LLC		\$ 10,000	Consultant
BrooksCardiel, PLLC		\$ 9,531	Auditor

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