CROPPER

an accountancy corporation

CERTIFIED PUBLIC ACCOUNTANTS

WESTERN HILLS WATER DISTRICT

FINANCIAL STATEMENTS

JUNE 30, 2014 and 2013

professional. personalized. service.

TABLE OF CONTENTS

Western Hills Water District
Management's Discussion and Analysis
For the year ended June 30, 2014

This section of the District's annual financial report presents our analysis of the District's financial performance during the fiscal year that ended on June 30, 2014. Please read it in conjunction with the Basic Financial Statements, which follow this section.

FINANCIAL HIGHLIGHTS

- The District's total assets decreased by $2.5 million, or 4.5%, to $51.6 million.
- During the year the District's operating revenue decreased by 16.1% to $1.9 million, while operating expenses increased by 15.1% to $4.3 million.
- Beginning of year net position was restated and reduced by $1.4 million due to a required change in accounting principle to implement GASB Statement # 65, which required the expensing of deferred bond costs.
- Net position decreased by $1.0 million to $(11.7) million.

OVERVIEW OF THE FINANCIAL STATEMENTS

The discussion and analysis are intended to serve as an introduction to Western Hills Water District's basic financial statements. The District's MD&A is comprised of five components: Net Position, Revenues & Expenses, Capital Assets, Long-Term Debt and Future Challenges.

BASIC FINANCIAL STATEMENTS

The Statement of Net Position includes all of the District's assets and liabilities and provides information about the nature and amounts of investments in resources (assets) and the obligations to District creditors (liabilities). It also provides the basis for computing rate of return, evaluating the capital structure of the District and assessing the liquidity and financial flexibility of the District.

The Financial Statements of the District report information about the District using accounting methods similar to those used by private section companies. These statements offer short and long-term financial information about its activities.

Capital assets, shown in Table 3, inform our bondholders that Western Hills Water District is spending their bond money in a manner that is consistent with increasing the assets that will ensure the District's overall future health.

Long-term debt has been secured by the special assessment on all property owned in this phase. These assessments will be charged through the year 2031. Even though the bonds are not the obligation of Western Hills Water District, the District has agreed to assume the accounting responsibility for these bonds.

FINANCIAL ANALYSIS OF THE DISTRICT

One of the most important questions asked about the District's finances is, "Is the District, as a whole better off or worse off as a result of the year's activities?" You can think of the District's net position (the difference between assets and liabilities) as one way to measure financial health or financial position. Over time, increases or decreases in the District's net position are one indicator of whether its financial health is improving or deteriorating. However, until a new entity has stabilized, there may be mitigating factors on why net position tends to fluctuate up and down as shown in Table 1 below.

NET POSITION

To begin our analysis, a summary of the District's Statement of Net Position is presented in Table 1. As can be seen from the table below, net position decreased by $1.0 million to $(11.7) million in fiscal year 2014. This decrease is a result of the following:

1. Assets decreased by $2.5 million, primarily due to depreciation of fixed assets and funding the current year's debt service on bonds payable.

2. Liabilities decreased by $93 thousand, due to a $1.66 million decrease in the bonds payable and long-term debt, partially offset by w $1.6 million increase in advances from World International LLC.

TABLE 1
Condensed Statements of Net Position
(in thousands)

	2014	2013
Current Assets	$ 584	$ 979
Restricted Assets	8,923	8,804
Fixed Assets	42,090	42,910
Other Assets	-	1,360
Total Assets	**51,597**	**54,053**
Current Liabilities	15,935	14,280
Long-Term Debt	47,327	49,076
Total Liabilities	**62,362**	**63,356**
Net Position	**$ (11,665)**	**$ (9,303)**

REVENUE & EXPENSES

Western Hill's financial statements are extremely lopsided on the expense side. This is due to the fact that Western Hills is a very new district and has very few customers. This will be the norm until residential and commercial projects are started and completed for this district. Please see 2014's challenges at the end of this report.

TABLE 2
Statement of Revenues and Expenses
For the Years ended June 30, 2014 and 2013
(in thousands)

	2014	2013	Total % Change Fav/(Unfav)
Total Operating Revenues	$ 1,851	$ 2,208	(16.1%)
Total Operating Expenses (less depreciation)	3,070	2,525	21.6%
Net Operating Loss Before Depreciation	**$ (1,219)**	**$ (317)**	**(385%)**

CAPITAL ASSETS

During 2014, the District had $12 thousand of additional investment in the new water treatment system.

TABLE 3
Capital Assets
(in thousands)

	2014	2013	Dollar Change	Total Percent Change
Water Treatment Facilities/Equipt	$ 11,541	$ 11,450	$ 91	0.8%
Pump Station & Well	3,058	3,058	-	0.0%
Aqueduct Turnout	746	746	-	0.0%
Wastewater Treatment Facility	28,104	28,104	-	0.0%
Back-up Generators	1,193	1,193	-	0.0%
Construction in Progress	10,314	10,065	249	2.4%
Other	99	48	51	106%
Subtotal	**55,055**	**54,664**	**391**	**0.7%**
Less Accumulated Depreciation	12,965	11,754	1,211	10.3%
Net Book Value	**$ 42,090**	**$ 42,910**	**$ (820)**	**(1.9%)**

LONG TERM DEBT

At year-end, the District had $49.1 million in long-term debt. This is a net decrease of $1.7 million from 2013, due to bond and note payments made during the year.

The District has outstanding general obligation debt stemming from Mello-Roos bonds issued in August 2001, December 2002, May 2004 and June 2005. The District's current average cost of capital is 6.45% in outstanding debt, as shown on Table 4. Amortized discount and deferred loss on refunding are not included in the outstanding bond balance shown on Table 4.

TABLE 4

Outstanding Debt

	Debt Balance	Average Rate
General Obligation Bonds	$46,290	6.45%
Caterpillar Note Payable	$ 2,786	6.41%

2014 CHALLENGES AND A LOOK AT THE FUTURE:

Western Hills Water District's assets are notably in place as of June 30, 2014.

Western Hill's ongoing projects include the WTP SWPPP Implementation and Pump Station 2 Upgrades. There will be additional Capital expenditure in 2015. The Plant's filtration system has to be upgraded, as well as a portion of the 30 inch main.

The District is in the process of pricing out new equipment to replace old, worn out and obsolete equipment since the plant and pumps stations are now over 15 years old.

2014 had its challenges due to the drought. The District was allotted zero percent water from January 2014 through September 2014. Due to the zero allotment the District had to use banked water. The board voted to pay for only 400 acre-feet. Of that 200 acre-feet was allotted to the golf courses which normally uses 950 acre-feet. The developers were forced to shut down one golf course.

Financial operations are limited due to a small customer base. At this time, the water company receives its income from one golf course, forty acres of grapes, residential housing and a water banking program.

The District receives income from the water banking program as long as the district has 500 or more acre-feet higher than the demand. In 2014 the district was at zero allotment and therefore no income was received from the water banking program.

CONTACTING THE DISTRICT'S FINANCIAL MANAGER

This financial report is designed to provide our customers, investors, and creditors with a general overview of the District's finances and to demonstrate the District's accountability for the money it receives.

If you have questions about this report or need additional financial information please contact Western Hills Water District.

Western Hills Water District
c/o Charles Smith, Financial Manager
9521 Morton Davis Drive
Diablo Grande, CA 95363-8610
Phone: (209) 892-0800 Fax: (209) 892-0858

office location
2700 Ygnacio Valley Road, Ste 230
Walnut Creek, CA 94598

(925) 932-3860 tel

mailing address
2977 Ygnacio Valley Rd, PMB 460
Walnut Creek, CA 94598

(925) 476-9930 efax

www.cropperaccountancy.com

INDEPENDENT AUDITORS' REPORT

The Governing Body
Western Hills Water District

Report on the Financial Statements

We have audited the accompanying financial statements of Western Hills Water District as of and for the year ended June 30, 2014 and 2013, and the related notes to the financial statements, which collectively comprise Western Hills Water District's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Western Hills Water 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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States as well as the State Controller's Audit Requirements for California Special Districts. 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 financial position of Western Hills Water District as of June 30, 2014 and 2013, and the changes in its financial position and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America as well as accounting systems prescribed for special districts by the Office of the California State Controller.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages I – IV 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.

Going Concern Assumption

The accompanying financial statements have been prepared assuming the District will continue as a going concern. The District continues to experience significant losses. The operating results coupled with the bankruptcy of the project's developer (see Note 8) raise substantial doubt about the District's ability to continue as a going concern. As discussed in Note 10, the financial statements do not include adjustments that might result from the outcome of this uncertainty.

Cropper Accountancy Corporation

CROPPER ACCOUNTANCY CORPORATION
Walnut Creek, California
December 2, 2014

WESTERN HILLS WATER DISTRICT
Statements of Net Position
June 30, 2014 and 2013

ASSETS

	2014	2013
Current Assets		
Cash	$ 34,326	329,589
Accounts receivable	105,087	80,073
Prepaid water charges	442,365	562,178
Meter inventory	2,400	6,480
Total current assets	584,178	978,320
Assets restricted for debt service, at current values		
Federated money market trust		
U.S. Treasury Obligations	8,923,286	8,803,973
Total restricted assets	8,923,286	8,803,973
Deferred bond costs, net of accummulated amortization of $785,265 for 2013	-	1,360,122
Fixed Assets, net of accumulated depreciation of $12,964,731 and $11,753,838 for 2014 and 2013, respectively	31,775,674	32,845,016
Construction in progress	10,314,727	10,065,189
Total assets	$ 51,597,865	$ 54,052,620

LIABILITIES AND NET POSITION

	2014	2013
Current Liabilities		
Accounts payable	4,062,480	4,109,023
Advances payable to World International LLC	9,063,896	7,466,228
Accrued interest payable	983,336	1,000,988
Customer deposits	66,500	44,750
Other current liabilities	10,816	8,486
Current portion of FSC gov't loan	278,269	260,805
Current portion of bonds payable	1,470,000	1,390,000
Total current liabilities	15,935,297	14,280,280
Caterpillar FSC gov't loan, net of current portion	2,507,254	2,785,523
Bonds payable, net of current portion	44,820,000	46,290,000
Total liabilities	63,262,551	63,355,803
Net Position		
Invested in capital assets, net of related debt	(6,985,122)	(7,816,123)
Restricted for bond and reserve funds	5,547,328	5,248,152
Unrestricted	(10,226,892)	(6,735,212)
Total net position	(11,664,686)	(9,303,183)
Total liabilities and net position	$ 51,597,865	$ 54,052,620

The accompanying notes are an integral part of these financial statements.

WESTERN HILLS WATER DISTRICT

Statements of Revenues, Expenses and Changes in Net Position

For the Years Ended June 30, 2014 and 2013

	2014	2013
Operating Revenue		
Water revenue		
Residential	$ 484,017	$ 427,267
Commercial	60,943	21,190
Golf course	954,114	1,026,633
Water banking program	1,056	404,360
Sewer and stormdrain	291,761	271,467
Construction	-	12,750
Winery	35,736	27,942
Other	23,718	16,013
Total operating revenues	1,851,345	2,207,622
Operating Expenses		
Labor and related expenses	514,906	466,147
Purchased water	859,497	776,510
Waste water hauling and disposal	250,196	194,531
Water treatment	279,182	291,292
Utilities/fuel for pump	321,803	340,650
Maintenance	122,681	86,467
Contractual services	206,194	173,934
Insurance	42,790	50,684
Licenses and fees	3,745	3,745
General and administrative	176,111	128,643
Depreciation	1,210,893	1,194,438
Water banking credits issued	285,178	-
Other	8,329	11,950
Total operating expenses	4,281,505	3,718,991
Operating loss	(2,430,160)	(1,511,369)
Non-Operating Revenue (Expenses)		
Property taxes	4,654,782	4,348,422
Investment income	58	146
Other income	95,724	81,160
Interest on bonded indebtedness	(3,101,126)	(2,930,013)
Other interest expense	(199,410)	(197,954)
Bond related expense	(21,249)	(15,244)
Amortization of bond expense	-	(77,306)
	1,428,779	1,209,211
Net loss	(1,001,381)	(302,158)
Net position at beginning of year	(9,303,183)	(9,001,025)
Change in accounting principle (Note 11)	(1,360,122)	-
Net position at beginning of year as restated	(10,663,305)	(9,001,025)
Total net position at end of year	$ (11,664,686)	$ (9,303,183)

The accompanying notes are an integral part of these financial statements.

WESTERN HILLS WATER DISTRICT
Statements of Cash Flows
For the Years Ended June 30, 2014 and 2013

	2014	2013
Cash flows from operating activities		
Receipts from customers and users	$ 1,848,081	$ 2,437,218
Payments to suppliers of goods and services	(2,480,106)	(2,176,453)
Payments to employees and related benefits	(514,906)	(466,147)
Net cash provided by operating activities	(1,146,931)	(205,382)
Cash flows from capital and related financing activities		
Bond indebtedness retired	(1,390,000)	(1,315,000)
Payments on Caterpillar loan	(260,805)	(244,437)
Fixed asset additions, including construction in progress	(391,089)	(12,153)
Interest paid on bonded indebtedness	(3,118,778)	(2,962,932)
Other interest paid	(199,410)	(197,954)
Bond related expenses	(21,249)	(15,244)
Advances received from developer	1,597,668	682,000
Property taxes collected for debt	4,654,782	4,348,422
Recovery of bond costs	95,724	81,160
Net used in capital and financing activities	966,843	363,862
Cash flows from investing activities		
Decrease (increase) in investments	(119,313)	(2,141,120)
Investment income received	58	146
Increase in meter inventory	4,080	-
Net cash provided (used) in investing activities	(115,175)	(2,140,974)
Net decrease in cash	(295,263)	(1,982,494)
Cash at beginning of year	329,589	2,312,083
Cash at end of year	$ 34,326	$ 329,589

Reconciliation of Operating Loss to Net Cash Provided By Operating Activities:

	2014	2013
Net operating loss	$ (2,430,160)	$ (1,511,369)
Adjustments to cash used in operating activities:		
Depreciation expense	1,210,893	1,194,438
(Increase) decrease in assets		
Accounts receivable	(25,014)	213,596
Prepaid water charges	119,813	(17,952)
Increase (decrease) in liabilities		
Accounts payable	(46,543)	(102,531)
Meter set deposits	21,750	16,000
Taxes and insurance	2,330	2,436
Net cash provided by operating activities	$ (1,146,931)	$ (205,382)

	2014	2013
Supplemental Disclosure of Non-Cash Transactions:		
Amortization of deferred bond costs	$ -	$ 77,306
Change in accounting principal- write off of deferred bond costs	$ 1,360,122	$ -

The accompanying notes are an integral part of these financial statements.

1. Summary of Significant Accounting Policies

The accounting policies of the Western Hills Water District (the "District") conform to accounting principles as applicable to governmental entities, which are classified as proprietary funds – business type, in the United States of America. The following is a summary of the more significant policies:

Reporting entity

For financial reporting purposes, in conformity with the Governmental Accounting Standards Board ("GASB") Codification Section 2100, defining the governmental reporting entity, the District includes all funds that are controlled by or dependent on the Board of Directors of the District. Since no other entities are controlled by or rely upon the District, the reporting entity consists solely of the District.

Diablo Grande Community Facilities District No.1 – Bond Issues (see Note 4)

In August 2001, the Western Hills Water District - Diablo Grande Community Facilities District No. 1 issued $21,000,000; in December 2002, issued $6,650,000; in May 2004 issued $20,000,000; and in January 2005 issued $9,350,000 in bonds pursuant to the Mello-Roos Community Facilities Act of 1982, as amended, for a total of $57,000,000 as of June 30, 2014. The bonds are secured by and payable from a pledge of special taxes to be levied on approximately 5,070 acres of real property within the boundaries of the District. The Bond provisions indicate that:

> *"Neither the faith and credit nor the taxing power of the water district, the County of Stanislaus, the State of California or any political subdivision thereof is pledged to the payment of the bonds. The bonds do not constitute a debt of the water district within the meaning of any statutory or constitutional debt limitation."*

Although the provisions indicate the bonds are not an obligation of the Western Hills Water District, the District has assumed the responsibility of accounting for the proceeds and the future debt service. The bond proceeds funded the acquisition of water and wastewater facilities by the District. The costs of water facilities incurred in prior years were contributed to the District by Diablo Grande LP (Diablo Grande), the developer of the Diablo Grande project. The bond proceeds, net of certain costs of issuance and debt reserve requirements, have been used or set aside for current and future facility improvements.

Fund accounting classification

The financial statements of the District are presented as those of an enterprise fund under the broad category of funds called proprietary funds, which also includes internal service funds. Enterprise funds account for operations that are financed and operated in a manner similar to private business enterprises – where the intent is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered substantially through user charges. The acquisition of the physical plant facilities required to provide these goods and services, as indicated above, were initially financed by the developer, for the District, in anticipation of proceeds from the bond issue, which will further fund the additions to plant and equipment.

1. Summary of Significant Accounting Policies (continued)

Basis of accounting

Enterprise funds are accounted for on the flow of economic measurement focus using the accrual basis of accounting. Revenues are recognized when they are earned, and expenses are recognized when they are incurred.

The GASB is the designated standard-setting body establishing governmental accounting and financial reporting principles.

The District follows alternative 1 of GASB 20 regarding the use of the pronouncements of the GASB and Financial Accounting Standards Board ("FASB") in its accounting. That is, the District follows (1) all GASB pronouncements and (2) FASB pronouncements, Accounting Principles Board ("APB") Opinions, and Accounting Research Bulletins ("ARB") issued on or before November 30, 1989, except those that conflict with GASB pronouncements.

Cash and cash equivalents

For the purpose of the statement of cash flows, the District considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents, including short-term certificates of deposit. To date, only cash in bank is applicable.

Investments

State statutes authorize the District to invest in obligations of the U.S. Treasury, the Local Agency Investment Fund of the State of California (LAIF), commercial paper, corporate bonds and repurchase agreements.

Meter inventory

Meter inventory is valued at average cost and recorded on the first in first out (FIFO) basis.

Fixed assets

Fixed assets are carried at historical cost or estimated historical cost if actual cost is not available. Contributed assets will be recorded at cost or estimated fair value on the date contributed.

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized.

Depreciation expense is provided on a straight-line basis over 3 to 40 years depending on the category.

Vacation accrual

Accumulated unpaid employee vacation benefits are recognized as liabilities of the District. Full-time, exempt and non-exempt employees will normally accrue vacation time at the 5 days for first year of employment (after a 90 day introductory period), 10 days per year for the 2nd through 5th years of employment and 1 additional day per year for each year beyond 5 years, to a maximum of 15 days.

1. Summary of Significant Accounting Policies (continued)

Net position

Net position is classified into three components: invested in capital assets, net of related debt; restricted for bond and reserve funds; and unrestricted. It is the policy of the District to spend funds in order from restricted to unrestricted.

Operating vs. non-operating revenues

Revenues related to providing water supply to customers and users are classified as operating revenue in the Statement of Revenues and Expenses and Changes in Retained Earnings (Deficit). All other revenues, including property taxes, are classified as non-operating revenue.

Property Taxes

Property tax revenue is recognized in the fiscal year for which the tax is levied. The County of Stanislaus levies, bills and collects property taxes for the District; all material amounts are collected by June 30.

Estimates in accounting

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 amounts of assets and liabilities, and consequently, the reported amounts of revenues and expenses in the financial statements. The District's estimates relate primarily to estimates of useful lives of fixed assets and the determination of an allowance for uncollectible receivables (for which there are none for June 30, 2014 or 2013). Actual results could differ from these estimates.

Reclassifications

To conform to the presentation in the current year financial statements, certain items in the comparative prior year financial statements have been reclassified.

New Accounting Pronouncements

In March of 2012, GASB issued GASBS No. 65, *Items Previously Reported as Assets and Liabilities*. This Statement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. This Statement also provides other financial reporting guidance related to the impact of the financial statement elements deferred outflows of resources and deferred inflows of resources, such as changes in the determination of the major fund calculations and limiting the use of the term deferred in financial statement presentations. The District is required to implement the provisions of this Statement for the current fiscal year (effective for periods beginning after December 31, 2012). This Statement did resulted in a change in accounting principal which required the restatement of the District's net position at June 30, 2013, as detailed in Note 11.

1. Summary of Significant Accounting Policies (continued)

New Accounting Pronouncements (continued)

In March of 2012, GASB issued GASBS No. 66, *Technical Corrections – 2012 – an Amendment of GASB Statements No. 10 and No. 62.* This Statement amends Statement No. 10, Accounting and Financial Reporting for Risk Financing and Related Insurance Issues, by removing the provision that limits fund-based reporting of an entity's risk financing activities to the general fund and the internal service fund type. This Statement also amends Statement No. 62 by modifying the specific guidance on accounting for (1) operating lease payments that vary from a straight-line basis, (2) the difference between the initial investment (purchase price) and the principal amount of a purchased loan or group of loans, and (3) servicing fees related to mortgage loans that are sold when the stated service fee rate differs significantly from a current (normal) servicing fee rate.

The objective of this Statement is to improve accounting and financial reporting for a governmental financial reporting entity by resolving conflicting guidance that resulted from the issuance of two pronouncements, Statements No. 54, Fund Balance Reporting and Governmental Fund Type Definitions, and No. 62, Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements. The District is required to implement the provisions of this Statement for the current fiscal year ended (effective for periods beginning after December 31, 2012). This Statement did not result in a change in current practice, or have a material effect on the financial statements of the District.

In June of 2012, GASB issued GASBS No. 67, *Financial Reporting for Pension Plans – an Amendment of GASB Statement No. 25.* The objective of this Statement is to improve financial reporting by state and local governmental pension plans. This Statement and Statement No. 68 establish a definition of a pension plan that reflects the primary activities associated with the pension arrangement—determining pensions, accumulating and managing assets dedicated for pensions, and paying benefits to plan members as they come due. This Statement replaces the requirements of Statements No. 25, Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans, and No. 50, Pension Disclosures, as they relate to pension plans that are administered through trusts or equivalent arrangements (hereafter jointly referred to as trusts) that meet certain criteria relating to irrevocable contributions, dedicated plan assets, and protection of plan assets from creditors. The requirements of Statements No. 25 and No. 50 remain applicable to pension plans that are not administered through trusts covered by the scope of this Statement and to defined contribution plans that provide post-employment benefits other than pensions.

For defined benefit pension plans, this Statement establishes standards of financial reporting for separately issued financial reports and specifies the required approach to measuring the pension liability of employers and non-employer contributing entities for benefits provided through the pension plan (the net pension liability), about which information is required to be presented. Distinctions are made regarding the particular requirements depending upon the type of pension plan administered, including cost-sharing multi-employer pension plans, in which the District participates. Cost-sharing plans are those in which the pension obligations to the employees of more than one employer are pooled and plan assets can be used to pay the benefits of the employees of any employer that provides pensions through the pension plan.

1. Summary of Significant Accounting Policies (continued)

New Accounting Pronouncements (continued)

The requirements of this Statement will improve financial reporting primarily through enhanced note disclosures and schedules of required supplementary information that will be presented by the pension plans. The new information will enhance the decision-usefulness of the financial reports of these pension plans, their value for assessing accountability, and their transparency by providing information about measures of net pension liabilities and explanations of how and why those liabilities changed from year to year. The net pension liability information will offer an up-to-date indication of the extent to which the total pension liability is covered by the fiduciary net position of the pension plan. The contribution schedule will provide measures to evaluate decisions related to the assessment of contribution rates in comparison to actuarially determined rates. In that circumstance, it also will provide information about whether employers and non-employer contributing entities are keeping pace with actuarially determined contribution measures. In addition, new information about rates of return on pension plan investments will inform financial report users about the effects of market conditions on the pension plan's assets over time and provide information for users to assess the relative success of the pension plan's investment strategy and the relative contribution that investment earnings provide to the pension plan's ability to pay benefits to plan members when they come due. The District is required to implement the provisions of this Statement for the fiscal year ending June 30, 2015 (effective for periods beginning after June 15, 2014). Because the District is not a pension plan, but rather a participant in a pension plan, this Statement did not result in a change in current practice, or have a material effect on the financial statements of the District.

In June of 2012, GASB issued GASBS No. 68, *Financial Reporting for Pension Plans – an Amendment of GASB Statement No. 27.* The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for pensions. This Statement replaces the requirements of Statement No. 27, Accounting for Pensions by State and Local Governmental Employers, as well as the requirements of Statement No. 50, Pension Disclosures, as they relate to pensions that are provided through pension plans administered as trusts that meet certain criteria relating to irrevocable contributions, dedicated plan assets, and protection of plan assets from creditors. The requirements of Statements 27 and 50 remain applicable for pensions that are not covered by the scope of this Statement.

Note disclosure and required supplementary information requirements about pensions also are addressed. Distinctions are made regarding the particular requirements for employers based on the number of employers whose employees are provided with pensions through the pension plan and whether pension obligations and pension plan assets are shared. Employers are classified into categories. Cost-sharing employers, such as the District, are those whose employees are provided with defined benefit pensions through cost-sharing multiple-employer pension plans. Cost-sharing plans are pension plans in which the pension obligations to the employees of more than one employer are pooled and plan assets can be used to pay the benefits of the employees of any employer that provides pensions through the pension plan.

1. Summary of Significant Accounting Policies (continued)

New Accounting Pronouncements (continued)

In financial statements prepared using the economic resources measurement focus and accrual basis of accounting, a cost-sharing employer that does not have a special funding situation is required to recognize a liability for its proportionate share of the net pension liability (of all employers for benefits provided through the pension plan)—the collective net pension liability. An employer's proportion is required to be determined on a basis that is consistent with the manner in which contributions to the pension plan are determined, and consideration should be given to separate rates, if any, related to separate portions of the collective net pension liability.

In addition, the effects of (1) a change in the employer's proportion of the collective net pension liability and (2) differences during the measurement period between the employer's contributions and its proportionate share of the total of contributions from employers included in the collective net pension liability are required to be determined. These effects are required to be recognized in the employer's pension expense in a systematic and rational manner over a closed period equal to the average of the expected remaining service lives of all employees that are provided with pensions through the pension plan (active employees and inactive employees). The portions of the effects not recognized in the employer's pension expense are required to be reported as deferred outflows of resources or deferred inflows of resources related to pensions. Employer contributions to the pension plan subsequent to the measurement date of the collective net pension liability also are required to be reported as deferred outflows of resources related to pensions.

A cost-sharing employer is required to recognize pension expense and report deferred outflows of resources and deferred inflows of resources related to pensions for its proportionate shares of collective pension expense and collective deferred outflows of resources and deferred inflows of resources related to pensions.

This Statement requires that notes to financial statements of cost-sharing employers include descriptive information about the pension plans through which the pensions are provided. Cost-sharing employers should identify the discount rate and assumptions made in the measurement of their proportionate shares of net pension liabilities. Cost-sharing employers also should disclose information about how their contributions to the pension plan are determined.

This Statement requires cost-sharing employers to present in required supplementary information 10-year schedules containing (1) the net pension liability and certain related ratios and (2) information about required contributions, contributions to the pension plan, and related ratios. The District is required to implement provisions of this Statement for the fiscal year ending June 30, 2015 (effective for periods beginning after June 15, 2014). This Statement will result in a change in current practice, but may not have a material effect on the financial statements of the District.

1. Summary of Significant Accounting Policies (continued)

New Accounting Pronouncements (continued)

In January of 2014, GASB issued GASBS No. 69, *Government Combinations and Disposals of Government Operations.* This Statement establishes accounting and financial reporting standards related to government combinations and disposals of government operations. As used in this Statement, government combinations includes a variety of transactions referred to as mergers, acquisitions, and transfers of operations.

This Statement requires the use of carrying values to measure the assets and liabilities in a government merger; it also requires measurements of assets acquired and liabilities assumed generally to be based upon their acquisition values, provides accounting and financial reporting guidance for disposals of government operations that have been transferred or sold, and requires disclosures to be made about government combinations and disposals of government operations to enable financial statement users to evaluate the nature and financial effects of those transactions. The District is required to implement provisions of this Statement for the year ended June 30, 2016 (effective for periods beginning after December 15, 2014). This Statement will not result in a change in current practice, or have a material effect on the financial statements of the District.

In April of 2013, GASB issued GASBS No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees.* The objective of this Statement is to improve accounting and financial reporting by state and local governments that extend and receive nonexchange financial guarantees. This Statement specifies the information required to be disclosed by governments that extend nonexchange financial guarantees. In addition, this Statement requires new information to be disclosed by governments that receive nonexchange financial guarantees. The requirements of this Statement will enhance comparability of financial statements among governments by requiring consistent reporting. The District is required to implement provisions of this Statement for the current fiscal year (effective for periods beginning after June 15, 2013). This Statement will not result in a change in current practice, or have a material effect on the financial statements of the District.

In November of 2013, GASB issued GASBS No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date—an amendment of GASB Statement No. 68*. The objective of this Statement is to address an issue regarding application of the transition provisions of Statement No. 68, Accounting and Financial Reporting for Pensions. The issue relates to amounts associated with contributions, if any, made by a state or local government employer or non-employer contributing entity to a defined benefit pension plan after the measurement date of the government's beginning net pension liability.

This Statement amends paragraph 137 of Statement 68 to require that, at transition, a government recognize a beginning deferred outflow of resources for its pension contributions, if any, made subsequent to the measurement date of the beginning net pension liability. Statement 68, as amended, continues to require that beginning balances for other deferred outflows of resources and deferred inflows of resources related to pensions be reported at transition only if it is practical to determine all such amounts.

1. Summary of Significant Accounting Policies (continued)

New Accounting Pronouncements (continued)

The District is required to implement provisions of this Statement simultaneously with the provisions of Statement 68 for the year ended June 30, 2015 (effective for periods beginning after June 15, 2014). This Statement will not result in a change in current practice or have a material effect on the financial statements of the District.

2. Cash and Investments

The California Government Code requires California banks and savings and loan associations to secure a Public Agency's deposits by pledging government securities as collateral. The market value of pledged securities must equal at least 110% of deposits. California law also allows financial institutions to secure Public Agency deposits by pledging first trust deed mortgage notes having a value of 150% of the Public Agency's total deposits.

The cash balance (before outstanding checks) was held in two institutions at June 30, 2014, and did not exceed the FDIC insured amount of $250,000. The June 30, 2014, investments in the US Treasury Money Market Trust of $8,923,286 were reflected on the balance sheet as assets restricted for debt services.

Credit Risk

Credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. Presented below is the minimum rating by the California Government Code and the actual rating as of the year-end for each investment type.

Investment Type	Fair Value	Minimum Legal Rating	Not Required To Be Rated	Rating as of Year End AAA	A	Unrated
US Treasury Money Market	$ 8,923,286	N/A	$ 8, 923,286	$ -	$ -	$ -

3. Fixed Assets

All purchased assets are valued at cost. In accordance with generally accepted accounting principles for proprietary entities, depreciation has been provided on the straight-line method over estimated useful lives of three to forty years.

3. Fixed Assets (continued)

The following reflects the changes in fixed assets for the year ended June 30, 2014:

	Balance June 30, 2013	Reclassifications & Additions	Balance June 30, 2014	Depreciable Life in Years
Water treatment facilities	$11,419,452	$ 28,721	$11,448,173	40
Water treatment equipment	31,106	61,730	92,836	3 to 5
Pump station & well	3,057,844	-	3,057,844	30
Aqueduct turnout	745,802	-	745,802	40
Wastewater treatment facility	28,103,909	-	28,103,909	40
Back-up generators	1,192,610	-	1,192,610	15
Aqueduct flow meter	-	49,643	49,643	15
Frog pond	10,803	-	10,803	30
Other	37,328	1,457	38,785	3 to 40
	44,598,854	141,551	44,740,405	
Accumulated depreciation	11,753,838	1,210,893	12,964,731	
Net book value	32,845,016	(1,069,342)	31,775,674	
Construction in progress	$10,065,189	$ 249,538	$10,314,727	n/a

4. "Mello-Roos" Assessment District – Western Hills Water District - Diablo Grande Community Facilities District No. 1

As mentioned in Note 1, WHWD has debt with original principal balances totaling $57,000,000, the proceeds of which fund facility assets. Interest rates on these bonds ranged from 2.25% to 6.875%.

The changes in the District's long-term obligations were as follows:

	Year Ended June 30, 2014	Year Ended June 30, 2013
Balance at beginning of year	$ 47,680,000	$ 48,995,000
Principal payments	(1,390,000)	(1,315,000)
Balance at end of year	$ 46,290,000	$ 47,680,000
Due in one year	$ 1,470,000	$ 1,390,000

4. "Mello-Roos" Assessment District - Western Hills Water District - Diablo Grande Community Facilities District No. 1 (continued)

The following is a debt service schedule to maturity:

2001 Bond

Fiscal Year Ending June 30,	Interest	Principal	Total
2015	1,172,859	525,000	1,697,859
2016	1,136,511	560,000	1,696,511
2017	1,097,819	595,000	1,692,819
2018	1,056,614	635,000	1,691,614
2019	1,012,561	680,000	1,692,561
Thereafter	7,358,568	14,435,000	21,793,568
	$ 12,834,932	$ 17,430,000	$ 30,264,932

2002 Bond

Fiscal Year Ending June 30,	Interest	Principal	Total
2015	310,669	215,000	525,669
2016	295,819	225,000	520,819
2017	280,125	240,000	520,125
2018	263,250	260,000	523,250
2019	245,194	275,000	520,194
Thereafter	1,162,855	3,495,000	4,657,855
	$ 2,557,912	$ 4,710,000	$ 7,267,912

2004 Bond

Fiscal Year Ending June 30,	Interest	Principal	Total
2015	981,575	470,000	1,451,575
2016	957,141	495,000	1,452,141
2017	930,675	525,000	1,455,675
2018	900,544	545,000	1,445,544
2019	866,794	580,000	1,446,794
Thereafter	6,773,678	13,955,000	20,728,678
	$ 11,410,407	$ 16,570,000	$ 27,980,407

4. "Mello-Roos" Assessment District - Western Hills Water District - Diablo Grande Community Facilities District No. 1 (continued)

2005 Bond

Fiscal Year Ending June 30,	Interest	Principal	Total
2015	415,013	260,000	675,013
2016	402,441	275,000	677,441
2017	388,963	285,000	673,963
2018	374,391	305,000	679,391
2019	358,734	315,000	673,734
Thereafter	2,576,298	6,140,000	8,716,298
	$ 4,515,840	$ 7,580,000	$ 12,095,840

All Bonds

Fiscal Year Ending June 30,	Interest	Principal	Total
2015	2,880,116	1,470,000	4,350,116
2016	2,791,912	1,555,000	4,346,912
2017	2,697,582	1,645,000	4,342,582
2018	2,594,799	1,745,000	4,339,799
2019	2,483,283	1,850,000	4,333,283
Thereafter	17,871,399	38,025,000	55,896,399
	$ 31,319,091	$ 46,290,000	$ 77,609,091

Reserve requirement restrictions

The provisions of the "official statements" of the bond issues require the following restrictions:

Reserve fund

The District is required to maintain an amount equal to the lesser of as of June 30, 2014:

(a) 10% of the original principal: $5,700,000
(b) 100% of the maximum annual debt service on the bonds based on years ended September 1: $4,350,116
(c) 125% of the average annual debt service: $5,392,234

The purpose of this $4,350,116 reserve is to be used for debt service, if needed. Amounts in excess of the requirement, due to interest thereon, can be transferred to the Bond Fund to be used for current debt service. When the Reserve Fund exceeds the requirement to redeem the remaining outstanding bonds such excess shall be transferred to the District to be used for any lawful purpose.

4. "Mello-Roos" Assessment District - Western Hills Water District - Diablo Grande Community Facilities District No. 1 (continued)

Bond fund

The Bond Fund consists of amounts held in trust by the Fiscal Agent for payments to bond holders (debt service). Annual special taxes assessed and collected shall be set aside for the debt service. During the fiscal years through June 30, 2014, property taxes were received on assessed property totaling $45,234,779 from inception. Debt service payments totaled $46,339,960 in interest and principal. $2,302,393 has been applied out of special tax fund proceeds set aside for early short-term interest payments, leaving $44,037,567 to be paid out of the "Bond Fund." Thus, $1,197,212 of the taxes assessed remains in the Bond Fund set aside.

Special Tax Fund

An amount was provided out of the bond proceeds sufficient, when combined with interest earnings thereon and on amounts in the "Reserve Fund", to provide for interest due in the short term through September 2, 2005, shortly after the bond issue.

Improvement Fund

The remaining proceeds of the bond issue after allowing for costs of issuance were set aside to reimburse improvement costs of $17,106,638 (2001 issue), $5,493,887 (2002 issue), $17,483,719 (2004 issue), and $8,026,517 (2005 issue).

At June 30, 2014, the reserve requirements were as follows:

Reserve Fund	$	4,350,116
Bond Fund		1,197,212
Total reserve requirement	$	5,547,328
Funds set aside for debt service at June 30, 2014	$	8,923,286

The indebtedness will be retired over a thirty-year period from assessed parcel taxes on the properties being developed, through the District.

5. Caterpillar Note Payable

In June of 2007, the District entered into a note agreement with Caterpillar Financial Services Corporation with the proceeds used for the government lease purchase of five Caterpillar generator sets packages with a SCADA system and four automatic transfer switches, all of which securitizes the agreement. The total amount borrowed under this agreement of $4,173,847 was originally payable in 102 equal monthly installments at 5.97% interest. The original agreement was amended on May 28, 2009, and again on June 15, 2012 to revise the payment schedule. The amended interest rate is 6.41%.

5. Caterpillar Note Payable (continued)

The following is a debt service schedule to maturity for the Caterpillar note payable, including the effect of both amendments:

Fiscal Year Ending June 30,	Interest	Principal	Total
2015	172,861	278,269	451,130
2016	154,646	296,484	451,130
2017	134,375	316,755	451,130
2018	113,164	337,966	451,130
2019	90,534	360,596	451,130
Thereafter	120,342	1,195,453	1,315,795
	$ 785,922	$ 2,785,523	$ 3,571,445

6. Retained Earnings (Deficit) and Capital

The District's assets are substantially in place as of June 30, 2014. However, the operations including water revenue will not be fully realized until the development is completed. At June 30, 2014, the primary customers were the 2 golf courses, clubhouse/restaurant, vineyard and the first phase of residential development homeowners. The development plan includes a hotel, single family homes, condos and public facilities. Until it comes to fruition, the water revenue will not cover expenses. It is anticipated, but not guaranteed, that the deficit will be funded by the developer.

7. Related Parties

Diablo Grande LP– the former Developer, which was owned by two corporations and a limited liability company. All of the property in the District is currently owned by the successor Developer, World International LLC. The former Developer had contributed $8,206,193 to the District to acquire property and fund the deficit operation to date. As of June 30, 2014 and 2013, the entire balance due from Diablo Grande LP had been written off due to its bankruptcy. See Note 8.

World International LLC – the successor Developer, which acquired the property contained in the District through the bankruptcy proceedings of Diablo Grande LP. As of June 30, 2014 and 2013, advances payable to World International LLC were $9,063,896 and $7,466,228, respectively.

8. Bankruptcy of Developer

On March 10, 2008 Diablo Grande, LP filed for Chapter 11 reorganization bankruptcy, and the assets of the company were eventually sold to World International LLC for $21,025,000 on October 7, 2008. As a result of this bankruptcy filing of the former Developer, the District determined that $1,700,153 of the outstanding receivable from Diablo Grande, LP was uncollectible, and recognized this expense in the Statement of Revenues and Expenses for the year ended June 30, 2005. In addition, $682,052 in special deposits that were held through Diablo Grande was forfeited through bankruptcy proceedings. The write-off of these special deposits was recognized as a $605,000 reduction in contributed capital on the Statements of Net Position and a $77,052 decrease in investment income on the Statement of Revenues, Expenses and Changes in Net Position for the year ended June 30, 2005.

9. Payables Concentration

Of the total accounts payable balance of $4,062,480 at June 30, 2014, $4,000,626 was a delinquent account payable to Veolia Water. Of the total accounts payable balance of $4,109,023 at June 30, 2013, $4,000,626 was a delinquent account payable to Veolia Water. As of December 2, 2014, Veolia Water has not pursued any litigation to collect the delinquent balance due from the District.

10. Going Concern

Continued operating losses coupled with the bankruptcy of the Developer raise doubts about the District's ability to continue as a going concern. The District's management is working with the owner of the development to promote the completion of the development resulting in sales of homes which will provide property tax revenues necessary to repay the outstanding bonds and cover operating costs of the District.

11. Change in Accounting Principle

The District was required to implement the provisions of GASBS No. 65 in the current fiscal year. In prior years, costs related to the issuance of bonds were amortized on a straight-line basis over the remaining period of the bonds outstanding. GASBS No. 65 no longer permits the capitalization and amortization of these costs, and as such, the net amount remaining at June 30, 2013, $1,360,122, is shown as a change in accounting principle on the Statement of Changes in Net Position.

12. Subsequent Events

Subsequent events have been evaluated through December 2, 2014, which is the date the financial statements were available to be issued.