



WESTERN HILLS WATER DISTRICT

FINANCIAL STATEMENTS

JUNE 30, 2015 and 2014

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INDEPENDENT AUDITORS' REPORT

The Board of Directors
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 years ended June 30, 2015 and 2014, 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 opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America 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 District'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 opinions.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of Western Hills Water District, as of June 30, 2015 and 2014, and the respective changes in financial position and, where applicable, cash flows thereof 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 District's operating results and net position 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
August 24, 2016

**Western Hills Water District
Management's Discussion and Analysis
For the year ended June 30, 2015**

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, 2015. Please read it in conjunction with the Basic Financial Statements, which follow this section.

FINANCIAL HIGHLIGHTS

- The District's total assets decreased by \$56,321, or 0.1%, to \$51.5 million.
- During the year the District's operating revenue decreased by 15.6% to \$1.6 million, while operating expenses decreased by 7.03% to \$4.0 million.
- Due to the 2014 Refunding of the 2001, 2002 and 2004 Special Tax Bonds, bond-related expenses increased from \$21 thousand to \$1.31 million. This was partially offset by a \$ 0.81 million decrease in interest expense due to more favorable interest rates on the refunded bonds.
- Net position decreased by \$1.2 million to \$(12.9) 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.

**Western Hills Water District
Management's Discussion and Analysis
For the year ended June 30, 2015**

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 \$1.2 million to \$(12.9) million in fiscal year 2015. This decrease is a result of the following:

1. Assets decreased by \$56 thousand, primarily due to depreciation of fixed assets partially offset by increases in cash exceeding a decrease in investments.
2. Liabilities increased by \$1.2 million, due to a \$2.1 million increase in advances from World International offset by a \$0.8 million decrease in the bonds payable and long-term debt (including the current portion).

**TABLE 1
Condensed Statements of Net Position
(in thousands)**

	<u>2015</u>	<u>2014</u>
Current Assets	\$ 4,334	\$ 584
Restricted Assets	5,986	8,923
Fixed Assets	41,222	42,090
Total Assets	<u>51,542</u>	<u>51,597</u>
Current Liabilities	16,717	15,935
Long-Term Debt	47,706	47,327
Total Liabilities	<u>64,423</u>	<u>62,362</u>
Net Position	<u>\$ (12,881)</u>	<u>\$ (11,665)</u>

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 2015's challenges at the end of this report.

**Western Hills Water District
Management's Discussion and Analysis
For the year ended June 30, 2015**

**TABLE 2
Statement of Revenues and Expenses
For the Years ended June 30, 2015 and 2014
(in thousands)**

	<u>2015</u>	<u>2014</u>	<u>Total % Change Fav/(Unfav)</u>
Total Operating Revenues	\$ 1,563	\$ 1,851	(15.6%)
Total Operating Expenses (less depreciation)	2,763	3,070	10.0%
Net Operating Loss Before Depreciation	\$ (1,200)	\$ (1,219)	1.5%

CAPITAL ASSETS

During 2015, the District had \$20 thousand of additional investment in the new water treatment system.

**TABLE 3
Capital Assets
(in thousands)**

	<u>2015</u>	<u>2014</u>	<u>Dollar Change</u>	<u>Total % Change</u>
Water Treatment Facilities/Equip	\$ 11,561	\$ 11,541	\$ 20	0.2%
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	10,638	10,314	324	3.1%
Other	104	99	5	5.1%
Subtotal	55,404	55,055	349	0.6%
Less Accumulated Depreciation	14,182	12,965	1,217	9.4%
Net Book Value	\$ 41,222	\$ 42,090	\$ (868)	(2.1%)

LONG TERM DEBT

At year-end, the District had \$48.3 million in long-term debt (including the current portion). This is a net decrease of \$0.8 million from 2014, due to the bond refunding and bond and note payments made during the year.

The District has outstanding general obligation debt stemming from Mello-Roos bonds issued in January 2005 and the 2014 Refunding Bonds issued in August of 2014. The District's current average cost of capital is 4.97% on outstanding debt, as shown on Table 4.

**Western Hills Water District
Management's Discussion and Analysis
For the year ended June 30, 2015**

**TABLE 4
Outstanding Debt**

	<u>Debt Balance</u>	<u>Average Rate</u>
General Obligation Bonds	<u>\$45,770</u>	<u>4.90%</u>
Caterpillar Note Payable	<u>\$ 2,507</u>	<u>6.41%</u>

2015 CHALLENGES AND A LOOK AT THE FUTURE:

Western Hills Water District's assets are notably in place as of June 30, 2015.

Western Hill's ongoing projects include the WTP SWPPP Implementation and Pump Station 2 Upgrades. There will be additional Capital expenditures in 2016. Due to the drought, new issues have arisen and must be addressed in 2016 and 2017.

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.

Due to the refinancing of the Mello-Roos Bonds, the District has approved the purchase of new pumps for the pump stations.

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 vineyards, 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 2015 the District was at 20% allotment and therefore received \$142,000 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
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WESTERN HILLS WATER DISTRICT
 Statements of Net Position
 June 30, 2015 and 2014

	2015	2014
<u>ASSETS</u>		
Current Assets		
Cash	\$ 3,804,165	34,326
Accounts receivable	85,523	105,087
Prepaid water charges	441,633	442,365
Meter inventory	2,400	2,400
Total current assets	4,333,721	584,178
Assets restricted for debt service, at current values		
Federated money market trust		
U.S. Treasury Obligations	5,986,024	8,923,286
Total restricted assets	5,986,024	8,923,286
Fixed Assets, net of accumulated depreciation of \$14,181,989 and \$12,964,731 for 2015 and 2014, respectively		
	30,583,550	31,775,674
Construction in progress	10,638,249	10,314,727
Total assets	\$ 51,541,544	\$ 51,597,865
<u>LIABILITIES</u>		
Current Liabilities		
Accounts payable	\$ 4,089,971	\$ 4,062,480
Advances payable to World International LLC	11,180,995	9,063,896
Accrued interest payable	790,747	983,336
Customer deposits	78,330	66,500
Other current liabilities	5,741	10,816
Current portion of FSC gov't loan	296,484	278,269
Current portion of bonds payable	275,000	1,470,000
Total current liabilities	16,717,268	15,935,297
Caterpillar FSC gov't loan, net of current portion	2,210,770	2,507,254
Bonds payable, net of current portion	45,495,000	44,820,000
Total liabilities	64,423,038	63,262,551
<u>NET POSITION</u>		
Invested in capital assets, net of related debt	(7,055,455)	(6,985,122)
Restricted for bond reserve funds	4,374,190	5,547,328
Unrestricted	(10,200,229)	(10,226,892)
Total net position	\$ (12,881,494)	\$ (11,664,686)
Total liabilities and net position	\$ 51,541,544	\$ 51,597,865

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

WESTERN HILLS WATER DISTRICT
 Statements of Revenues, Expenses and Changes in Net Position
 June 30, 2015 and 2014

	2015	2014
Operating Revenue		
Water revenue		
Residential	\$ 517,534	\$ 484,017
Commercial	95,499	60,943
Golf course	478,846	954,114
Water banking program	141,962	1,056
Sewer and stormdrain	281,946	291,761
Winery	17,897	35,736
Other	28,910	23,718
Total operating revenues	1,562,594	1,851,345
Operating Expenses		
Labor and related expenses	553,153	514,906
Purchased water	867,909	859,497
Waste water hauling and disposal	258,428	250,196
Water treatment	314,743	279,182
Utilities/fuel for pump	261,505	321,803
Maintenance	65,674	122,681
Contractual services	194,641	206,194
Insurance	44,039	42,790
Licenses and fees	3,745	3,745
General and administrative	197,338	176,111
Depreciation	1,217,259	1,210,893
Water banking credits issued	-	285,178
Other	1,900	8,329
Total operating expenses	3,980,334	4,281,505
Operating loss	(2,417,740)	(2,430,160)
Non-Operating Revenue (Expenses)		
Property taxes	4,938,338	4,654,782
Investment income	855	58
Other income	82,128	95,724
Interest on bonded indebtedness	(2,288,654)	(3,101,126)
Other interest expense	(221,134)	(199,410)
Bond related expense	(1,310,601)	(21,249)
	1,200,932	1,428,779
Net loss	(1,216,808)	(1,001,381)
Net position at beginning of year	(11,664,686)	(9,303,183)
Change in accounting principle (Note 8)	-	(1,360,122)
Net position at beginning of year as restated	(11,664,686)	(10,663,305)
Total net position at end of year	\$ (12,881,494)	\$ (11,664,686)

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

WESTERN HILLS WATER DISTRICT
Statements of Cash Flows
June 30, 2015 and 2014

	2015	2014
Cash flows from operating activities		
Receipts from customers and users	\$ 1,593,988	\$ 1,848,081
Payments to suppliers of goods and services	(2,186,774)	(2,480,106)
Payments to employees and related benefits	(553,153)	(514,906)
Net cash provided (used) in operating activities	(1,145,939)	(1,146,931)
Cash flows from capital and related financing activities		
Bond indebtedness retired	(39,025,000)	(1,390,000)
Bond refunding proceeds	38,505,000	-
Payments on Caterpillar loan	(278,269)	(260,805)
Fixed asset additions, including construction in progress	(348,657)	(391,089)
Interest paid on bonded indebtedness	(2,481,243)	(3,118,778)
Other interest paid	(221,134)	(199,410)
Bond related expenses	(1,310,601)	(21,249)
Advances received from developer	2,117,099	1,597,668
Property taxes collected for debt	4,938,338	4,654,782
Recovery of bond costs	82,128	95,724
Net provided (used) in capital and financing activities	1,977,661	966,843
Cash flows from investing activities		
Proceeds from sales of investments	2,937,262	(119,313)
Investment income received	855	58
Sale of meter inventory	-	4,080
Net cash provided (used) in investing activities	2,938,117	(115,175)
Net increase (decrease) in cash	3,769,839	(295,263)
Cash at beginning of year	34,326	329,589
Cash at end of year	\$ 3,804,165	\$ 34,326
Reconciliation of Operating Loss to Net Cash Provided By Operating Activities:		
Net operating loss	\$ (2,417,740)	\$ (2,430,160)
Adjustments to cash used in operating activities:		
Depreciation expense	1,217,259	1,210,893
(Increase) decrease in assets		
Accounts receivable	19,564	(25,014)
Prepaid water charges	732	119,813
Increase (decrease) in liabilities		
Accounts payable	27,491	(46,543)
Meter set deposits	11,830	21,750
Taxes and insurance	(5,075)	2,330
Net cash provided (used) in operating activities	\$ (1,145,939)	\$ (1,146,931)
Supplemental Disclosure of Non-Cash Transactions:		
Change in accounting principal- write off of deferred bond costs	\$ -	\$ 1,360,122

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

WESTERN HILLS WATER DISTRICT
Notes to Financial Statements
June 30, 2015 and 2014

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, 2015. In August, 2014, the 2001, 2002, and 2004 bonds, which had a remaining principal balance of \$38,710,000 were refunded by the 2014 Refunding Bond, with a principal balance of \$38,450,000. The 2005 bonds had a remaining principal balance of \$7,320,000 at June 30, 2015. 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.

WESTERN HILLS WATER DISTRICT
Notes to Financial Statements
June 30, 2015 and 2014

1. Summary of Significant Accounting Policies (continued)

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.

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.

WESTERN HILLS WATER DISTRICT
Notes to Financial Statements
June 30, 2015 and 2014

1. Summary of Significant Accounting Policies (continued)

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.

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, 2015 or 2014). Actual results could differ from these estimates.

WESTERN HILLS WATER DISTRICT
Notes to Financial Statements
June 30, 2015 and 2014

1. Summary of Significant Accounting Policies (continued)

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 February of 2015, GASB issued GASBS No. 72, *Fair Value Measurement and Application*. Fair value is described as an exit price. This Statement provides guidance for determining a fair value measurement for financial reporting purposes. This Statement also provides guidance for applying fair value to certain investments and disclosures related to all fair value measurement

This Statement requires a government to use valuation techniques that are appropriate under the circumstances and for which sufficient data are available to measure fair value. The techniques should be consistent with one or more of the following approaches: the market approach, the cost approach, or the income approach. This Statement generally requires investments to be measured at fair value. An investment is defined as a security or other asset that (a) a government holds primarily for the purpose of income or profit and (b) has a present service capacity based solely on its ability to generate cash or to be sold to generate cash. The requirements of this Statement will enhance comparability of financial statements among governments by requiring measurement of certain assets and liabilities at fair value using a consistent and more detailed definition of fair value and accepted valuation techniques. This Statement also will enhance fair value application guidance and related disclosures in order to provide information to financial statement users about the impact of fair value measurements on a government's financial position. The District is required to implement the provisions of this Statement for the fiscal year ended June 30, 2016 (effective for periods beginning after June 15, 2015). This Statement will not result in a change in current practice, or have a material effect on the financial statements of the District.

In June of 2015, GASB issued GASBS No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*. This Statement supersedes Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, and reduces the GAAP hierarchy to two categories of authoritative GAAP and addresses the use of authoritative and non-authoritative literature in the event that the accounting treatment for a transaction or other event is not specified within a source of authoritative GAAP.

The District is required to implement the provisions of this Statement for the fiscal year ended June 30, 2015 (effective for periods beginning after June 15, 2015), and should be applied retroactively. This Statement will result in a change in current practice, but will not have a material effect on the financial statements of the District.

WESTERN HILLS WATER DISTRICT
Notes to Financial Statements
June 30, 2015 and 2014

1. Summary of Significant Accounting Policies (continued)

New Accounting Pronouncements (continued)

In August of 2015, GASB issued GASBS No. 77, Tax Abatement Disclosures. This Statement requires governments that enter into tax abatement agreements to disclose the following information about the agreements:

- Brief descriptive information, such as the tax being abated, the authority under which tax abatements are provided, eligibility criteria, the mechanism by which taxes are abated, provisions for recapturing abated taxes, and the types of commitments made by tax abatement recipients
- The gross dollar amount of taxes abated during the period
- Commitments made by a government, other than to abate taxes, as part of a tax abatement agreement.

Governments should organize those disclosures by major tax abatement program and may disclose information for individual tax abatement agreements within those programs.

The District is required to implement the provisions of this Statement for the fiscal year ended June 30, 2017 (effective for periods beginning after December 15, 2015). This Statement may result in a change in current practice, and 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, 2015, and exceeded the FDIC insured amount of \$250,000 by \$3,621,255. The June 30, 2015, investments in the US Treasury Money Market Trust of \$5,986,024 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	Legal Rating	Minimum Not Required To Be Rated	Rating as of Year End		
				AAA	A	Unrated
US Treasury Money Market	\$ 5,986,024	N/A	\$ 5,986,024	\$ -	\$ -	\$ -

WESTERN HILLS WATER DISTRICT
Notes to Financial Statements
June 30, 2015 and 2014

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.

The following reflects the changes in fixed assets for the year ended June 30, 2015:

	Balance <u>June 30, 2014</u>	Reclassifications & Additions	Balance <u>June 30, 2015</u>	Depreciable <u>Life in Years</u>
Water treatment facilities	\$11,448,173	\$ 15,279	\$11,463,452	40
Water treatment equipment	92,836	5,513	98,349	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	38,785	4,342	43,127	3 to 40
	<u>44,740,405</u>	<u>25,134</u>	<u>44,765,539</u>	
Accumulated depreciation	<u>12,964,731</u>	<u>1,217,258</u>	<u>14,181,989</u>	
Net book value	<u>\$31,775,674</u>	<u>\$ (1,192,124)</u>	<u>\$30,583,550</u>	
Construction in progress	<u>\$10,314,727</u>	<u>\$ 323,522</u>	<u>\$10,638,249</u>	n/a

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

Special Tax Revenue Bonds – 2005

In January 2005, the District issued \$9,350,000 of Special Tax Revenue Bonds for Wastewater Facilities Improvements, with interest rates ranging from 2.75% to 5.80%. The interest rate on the remaining bonds at June 30, 2015 ranged from 4.65 to 5.80%. The bonds are secured by a pledge of revenue. Principal payments are due annually on September 1, commencing in fiscal year 2005, and interest is payable semi-annually on September 1 and March 1 of each year.

Refunding Revenue Bonds – 2014

In August 2014, the District issued \$38,505,000 of Refunding Revenue Bonds with interest rates ranging from 2.00% to 5.30%. The Bonds are secured by a pledge of special tax revenue. Principal payments are due annually on September 1, and interest is payable semi-annually on September 1 and March 1.

WESTERN HILLS WATER DISTRICT
Notes to Financial Statements
June 30, 2015 and 2014

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

The District issued the 2014 Refunding Revenue Bonds to advance refund the 2001, 2002, and 2004 Revenue Installment Certificates, which had interest rates of 4.65 to 6.875%. The net proceeds were deposited in an escrow fund to service and redeem the debt. As a result, the advance refunding met the requirements of an in-substance debt defeasance, and the outstanding balance of the 2001, 2002, and 2004 debt was removed from the District’s accounts. The 2001, 2002, and 2004 debt issues no longer have any outstanding balance.

Total costs of the 2014 Refunding Revenue Bonds recognized as non-operating expense for the fiscal year ended June 30, 2014 was \$1,310,601, including an original issue discount of \$592,787. The District completed the 2014 refunding of the 2001, 2002 and 2004 special tax bonds to reduce its total debt service (net of the costs of the refunding) over the next 17 years by \$3,050,334 and to obtain an economic gain of \$2,771,279. The economic gain is the difference between the present values of the old and new debt service payments, based on the effective interest rate on the 2014 Refunding Revenue Bonds of 5.2%.

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

	<u>Year Ended June 30, 2015</u>	<u>Year Ended June 30, 2014</u>
Balance at beginning of year	\$ 46,290,000	\$ 47,680,000
New issuance- bond refunding	38,505,000	-
Bond retirements	(38,710,000)	
Principal payments	(315,000)	(1,390,000)
Balance at end of year	<u>\$ 45,770,000</u>	<u>\$ 46,290,000</u>
Due in one year	<u>\$ 275,000</u>	<u>\$ 1,470,000</u>

Debt Schedules

The following are debt service schedules to maturity:

Fiscal Year Ending June 30,	2005 Bond		
	Interest	Principal	Total
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
2020	342,121	330,000	672,121
Thereafter	2,234,177	5,810,000	8,044,177
	<u>\$ 4,100,827</u>	<u>\$ 7,320,000</u>	<u>\$ 11,420,827</u>

WESTERN HILLS WATER DISTRICT
Notes to Financial Statements
June 30, 2015 and 2014

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

Debt Schedules (continued)

The following are debt service schedules to maturity:

<u>2014 Bond</u>			
Fiscal Year Ending June 30,	Interest	Principal	Total
2016	\$ 1,831,410	\$ -	\$ 1,831,410
2017	1,826,660	475,000	2,301,660
2018	1,794,010	1,860,000	3,654,010
2019	1,737,310	1,920,000	3,657,310
2020	1,669,010	1,975,000	3,644,010
Thereafter	<u>11,096,958</u>	<u>32,220,000</u>	<u>43,316,958</u>
	<u>\$19,955,358</u>	<u>\$38,450,000</u>	<u>\$58,405,358</u>

<u>All Bonds</u>			
Fiscal Year Ending June 30,	Interest	Principal	Total
2016	\$ 2,233,851	\$ 275,000	\$ 2,508,851
2017	2,215,623	760,000	2,975,623
2018	2,168,401	2,165,000	4,333,401
2019	2,096,044	2,235,000	4,331,044
2020	2,011,131	2,305,000	4,316,131
Thereafter	<u>13,331,135</u>	<u>38,030,000</u>	<u>51,361,135</u>
	<u>\$ 24,056,185</u>	<u>\$ 45,770,000</u>	<u>\$ 69,826,185</u>

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, 2015:

- (a) 10% of the original principal: \$4,766,330
- (b) 100% of the maximum annual debt service on the bonds based on years ended September 1:
\$4,374,190
- (c) 125% of the average annual debt service: \$5,190,389

WESTERN HILLS WATER DISTRICT
Notes to Financial Statements
June 30, 2015 and 2014

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

Reserve fund (continued)

The purpose of this \$4,374,190 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.

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, 2015, property taxes were received on assessed property totaling \$50,173,117 from inception. Debt service payments totaled \$50,900,720 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 \$48,598,327 to be paid out of the “Bond Fund.” Thus, \$1,574,790 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.

At June 30, 2015, the reserve requirements were as follows:

Reserve Fund- 2014 Bond	\$ 3,686,110
Reserve Fund- 2005 Bond	688,080
Total reserve requirement	\$ <u>4,374,190</u>
Funds set aside for debt service at June 30, 2015	\$ <u>5,986,024</u>

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

WESTERN HILLS WATER DISTRICT
Notes to Financial Statements
June 30, 2015 and 2014

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%.

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

Fiscal Year Ending June 30,	Interest	Principal	Total
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
2020	66,558	384,572	451,130
Thereafter	53,784	810,881	864,865
	<u>\$ 613,061</u>	<u>\$ 2,507,254</u>	<u>\$ 3,120,315</u>

6. Retained Earnings (Deficit) and Capital

The District's assets are substantially in place as of June 30, 2015. However, the operations including water revenue will not be fully realized until the development is completed. At June 30, 2015, the primary customers were the golf course, 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, 2015 and 2014, the entire balance due from Diablo Grande LP had been written off due to its bankruptcy.

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, 2015 and 2014, advances payable to World International LLC were \$11,180,995 and \$9,063,896, respectively.

WESTERN HILLS WATER DISTRICT
Notes to Financial Statements
June 30, 2015 and 2014

8. Change in Accounting Principle

The District was required to implement the provisions of GASBS No. 65 in the fiscal year ended June 30, 2014. 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 for the year ended June 30, 2014.

9. Payables Concentration

Of the total accounts payable balance of \$4,089,971 and \$4,062,480 at June 30, 2015 and 2014, respectively, \$4,000,626 was a delinquent account payable to Veolia Water in both years. As of August 24, 2016, 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. Subsequent Events

Subsequent events have been evaluated through August 24, 2016, which is the date the financial statements were available to be issued.

On July 15, 2015, the District issued 16 year bonds in the amount of \$7,260,000 to refund the remaining balance of the 2005 Special Tax Bonds.