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**WESTERN HILLS WATER DISTRICT**

**FINANCIAL STATEMENTS**

**JUNE 30, 2016 and 2015**

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**Western Hills Water District  
Management's Discussion and Analysis  
For the year ended June 30, 2016**

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, 2016. Please read it in conjunction with the Basic Financial Statements, which follow this section.

**FINANCIAL HIGHLIGHTS**

- The District's total assets increased by \$757,109, or 1.5%, to \$52.30 million.
- During the year the District's operating revenue increased by 32.1% to \$2.06 million, while operating expenses increased by 14.1% to \$4.54 million.
- Due to the 2015 Refunding of the 2005 Special Tax Bonds, bond-related expenses decreased from \$1.31 million to \$0.42 million. This was partially offset by a \$0.12 million decrease in interest expense due to more favorable interest rates on the refunded bonds.
- Net position decreased by \$1.11 million to \$(13.99) 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, 2016**

**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 \$1.11 million to \$(13.99) million in fiscal year 2016. This decrease is a result of the following:

1. Assets increased by \$0.76 million, primarily due the bond refinance and money made available for capital projects along with the depreciation of fixed assets.
2. Liabilities increased by \$1.86 million, due to a \$2.30 million increase in advances from World International and by a \$0.36 million increase in the bonds payable and long-term debt (including the current portion).

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

	<b>2016</b>	<b>2015</b>
Current Assets	\$ 7,225	\$ 4,334
Restricted Assets	4,589	5,986
Fixed Assets	40,485	41,222
<b>Total Assets</b>	<b>52,299</b>	<b>51,542</b>
Current Liabilities	19,157	16,717
Long-Term Debt	47,129	47,706
<b>Total Liabilities</b>	<b>66,286</b>	<b>64,423</b>
<b>Net Position</b>	<b>\$ (13,987)</b>	<b>\$ (12,881)</b>

**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 2016's challenges at the end of this report.

**Western Hills Water District  
Management's Discussion and Analysis  
For the year ended June 30, 2016**

**TABLE 2  
Statement of Revenues and Expenses  
For the Years ended June 30, 2016 and 2015  
(in thousands)**

	<u>2016</u>	<u>2015</u>	<b>Total % Change Fav/(Unfav)</b>
Total Operating Revenues	\$ 2,064	\$ 1,563	32.1%
Total Operating Expenses (less depreciation)	<u>3,320</u>	<u>2,763</u>	<u>20.2%</u>
<b>Net Operating Loss Before Depreciation</b>	<b><u>\$ (1,256)</u></b>	<b><u>\$ (1,200)</u></b>	<b><u>(4.7%)</u></b>

**CAPITAL ASSETS**

During 2016, the District had \$220 thousand of additional investment in the new water treatment system.

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

	<u>2016</u>	<u>2015</u>	<b>Dollar Change</b>	<b>Total % Change</b>
Water Treatment Facilities/Equip	\$ 11,781	\$ 11,561	\$ 220	1.90%
Pump Station & Well	3,107	3,058	49	1.60%
Aqueduct Turnout	746	746	-	0.00%
Wastewater Treatment Facility	28,104	28,104	-	0.00%
Back-up Generators	1,193	1,193	-	0.00%
Construction in Progress	11,894	10,638	256	2.41%
Other	<u>65</u>	<u>104</u>	<u>(39)</u>	<u>(37.50%)</u>
<b>Subtotal</b>	<b>55,890</b>	<b>55,404</b>	<b>486</b>	<b>0.88%</b>
Less Accumulated Depreciation	<u>15,405</u>	<u>14,182</u>	<u>1,223</u>	<u>8.62%</u>
<b>Net Book Value</b>	<b><u>\$ 40,485</u></b>	<b><u>\$ 41,222</u></b>	<b><u>\$ (737)</u></b>	<b><u>(1.79%)</u></b>

**LONG TERM DEBT**

At year-end, the District had \$47.92 million in long-term debt (including the current portion). This is a net decrease of \$0.36 million from 2015, 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 2015 Refunding Bonds issued in July of 2015. The District's current average cost of capital is 4.40% on outstanding debt, as shown on Table 4.

**Western Hills Water District  
Management's Discussion and Analysis  
For the year ended June 30, 2016**

**TABLE 4  
Outstanding Debt**

	<u>Debt Balance</u>	<u>Average Rate</u>
General Obligation Bonds	\$45,710	4.31%
Caterpillar Note Payable	\$ 2,211	6.08%

**2016 CHALLENGES AND A LOOK AT THE FUTURE:**

Western Hills Water District's assets are notably in place as of June 30, 2016.

Western Hill's ongoing projects include the WTP SWPPP Implementation and Pump Station 2.

Upgrades: There will be additional capital expenditures in 2016 – 2017 funded by proceeds from the refinancing of the bonds in 2014 and 2015.

Purchases: The District purchased four raw water pumps and refurbished four raw water pumps as a backup for new pumps that are housed in four pump stations along the Diablo Grande Parkway. As of June 2016 the new pumps have been installed and the four refurbished pumps will be installed in fiscal 2017-2018.

Financial: Revenue is 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.

Setback: Steps were taken to address the ongoing loss of the district. The district performed a rate study, by an outside firm that produced a rate increase proposal based strictly on the cost incurred by residents (treated water) and by the golf course and vineyards (raw water). This study proposed a modest rate increase for all users. Being that the District is a Prop. 218 public utility the rate increase had to be voted in by the residents. The rate increase was defeated by a large margin.

Water Costs: The District receives income from the water banking program as long as the District has 500 or more acre-feet greater than the demand. In 2016 the District was allotted 65%, of the total 8,000 acre feet, and therefore received \$669,000 from the water banking program. This helped to offset the \$1.2 million in water purchase cost.

Future: There will be a lot of hurdles in fiscal 2018 for the district to get through. Rising water treatment costs without the increase of revenue. Concerns that mandated certified plant operators will not be hired due to higher competition and wages from other water districts. Increased demands, by residents; on a team of eight employees who put in many hours of overtime during the peak season, as there are no extra funds to relieve the already overburdened staff; will increase the cash requirements from the developer.

**Western Hills Water District  
Management's Discussion and Analysis  
For the year ended June 30, 2016**

**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.

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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, 2016 and 2015, 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, 2016 and 2015, and the respective changes in financial position and, where applicable, cash flows thereof for the years 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 – V 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 9, the financial statements do not include adjustments that might result from the outcome of this uncertainty.

  
CROPPER ACCOUNTANCY CORPORATION  
Walnut Creek, California  
June 12, 2017

WESTERN HILLS WATER DISTRICT  
 Statements of Net Position  
 June 30, 2016 and 2015

	2016	2015
<b><u>ASSETS</u></b>		
Current Assets		
Cash	\$ 135,791	\$ 266,622
Restricted cash (Note 2)	5,820,586	3,537,543
Accounts receivable	68,891	85,523
Prepaid water charges	531,392	441,633
Other prepaid expenses	5,836	-
Accounts receivable water banking	659,688	-
Meter inventory	2,400	2,400
Total current assets	7,224,584	4,333,721
Assets restricted for debt service, at current values		
Federated money market trust		
U.S. Treasury Obligations (Note 2)	4,589,144	5,986,024
Total restricted assets	4,589,144	5,986,024
Fixed Assets, net of accumulated depreciation of \$15,405,086 and \$14,181,989 for 2016 and 2015, respectively (Note 3)		
	29,591,200	30,583,550
Construction in progress (Note 3)		
	10,893,725	10,638,249
Total assets	52,298,653	51,541,544
<b><u>LIABILITIES</u></b>		
Current Liabilities		
Accounts payable (Note 8)	4,070,316	4,089,971
Advances payable to World International LLC (Note 7)	13,475,995	11,180,995
Accrued interest payable	712,687	790,747
Customer deposits	104,187	78,330
Other current liabilities	2,498	5,741
Current portion of FSC government loan (Note 5)	316,755	296,484
Current portion of bonds payable (Note 4)	475,000	275,000
Total current liabilities	19,157,438	16,717,268
Caterpillar FSC government loan, net of current portion (Note 5)		
	1,893,753	2,210,770
Bonds payable, net of current portion (Note 4)		
	45,235,000	45,495,000
Total liabilities	66,286,191	64,423,038
<b><u>NET POSITION</u></b>		
Invested in capital assets, net of related debt	(7,435,583)	(7,055,455)
Restricted for bond reserve funds	4,373,266	4,374,190
Unrestricted (Note 6)	(10,925,221)	(10,200,229)
Total net position	(13,987,538)	(12,881,494)
Total liabilities and net position	\$ 52,298,653	\$ 51,541,544

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, 2016 and 2015

	2016	2015
Operating Revenue		
Water revenue		
Residential	\$ 552,610	\$ 517,534
Commercial	83,831	95,499
Golf course	352,725	478,846
Water banking program	669,000	141,962
Sewer and stormdrain	300,722	281,946
Winery	6,924	17,897
Other	98,272	28,910
Total operating revenues	2,064,084	1,562,594
Operating Expenses		
Labor and related expenses	488,832	553,153
Purchased water	1,414,684	867,909
Waste water hauling and disposal	310,325	258,428
Water treatment	283,944	314,743
Utilities/fuel for pump	206,090	261,505
Maintenance	131,232	65,674
Contractual services	215,664	194,641
Insurance	61,487	44,039
Licenses and fees	3,925	3,745
General and administrative	203,878	197,338
Depreciation	1,223,097	1,217,259
Other	-	1,900
Total operating expenses	4,543,158	3,980,334
Operating loss	(2,479,074)	(2,417,740)
Non-Operating Revenue (Expenses)		
Property taxes	4,405,892	4,938,338
Investment income	15,290	855
Other income	80,408	82,128
Interest on bonded indebtedness	(2,117,761)	(2,288,654)
Other interest expense	(154,390)	(221,134)
Bond related expense	(421,409)	(1,310,601)
Development expenses	(435,000)	-
Total non-operating revenues (expenses)	1,373,030	1,200,932
Change in net position	(1,106,044)	(1,216,808)
Net position at beginning of year	(12,881,494)	(11,664,686)
Total net position at end of year	\$ (13,987,538)	\$ (12,881,494)

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

WESTERN HILLS WATER DISTRICT  
Statements of Cash Flows  
June 30, 2016 and 2015

	2016	2015
Cash flows from operating activities		
Receipts from customers and users	\$ 1,446,885	\$ 1,593,988
Payments to suppliers of goods and services	(2,949,722)	(2,186,774)
Payments to employees and related benefits	(488,832)	(553,153)
Net cash provided (used) in operating activities	(1,991,669)	(1,145,939)
Cash flows from capital and related financing activities		
Bond indebtedness retired	(7,320,000)	(39,025,000)
Bond refunding proceeds	7,260,000	38,505,000
Payments on Caterpillar loan	(296,746)	(278,269)
Fixed asset additions, including construction in progress	(486,223)	(348,657)
Interest paid on bonded indebtedness	(2,195,821)	(2,481,243)
Other interest paid	(154,390)	(221,134)
Bond related expenses	(421,409)	(1,310,601)
Development expenses	(435,000)	-
Advances received from developer	2,295,000	2,117,099
Property taxes collected for debt	4,405,892	4,938,338
Recovery of bond costs	80,408	82,128
Net provided (used) in capital and financing activities	2,731,711	1,977,661
Cash flows from investing activities		
Proceeds from sales of investments	1,396,880	2,937,262
Investment income received	15,290	855
Net cash provided (used) in investing activities	1,412,170	2,938,117
Net increase (decrease) in cash	2,152,212	3,769,839
Cash at beginning of year	3,804,165	34,326
Cash at end of year	\$ 5,956,377	\$ 3,804,165
Presentation on Statement of Net Position		
Cash	\$ 135,791	\$ 266,622
Restricted Cash	5,820,586	3,537,543
Total Cash	\$ 5,956,377	\$ 3,804,165
Reconciliation of Operating Loss to Net Cash		
Provided by Operating Activities:		
Net operating loss	\$ (2,479,074)	\$ (2,417,740)
Adjustments to cash used in operating activities:		
Depreciation expense	1,223,097	1,217,259
(Increase) decrease in Accounts receivable	16,632	19,564
(Increase) decrease in Prepaid water charges	(89,759)	732
(Increase) decrease in Prepaid expenses	(5,836)	-
(Increase) decrease in Accounts receivable water banking	(659,688)	-
Increase (decrease) in Accounts payable	(19,655)	27,491
Increase (decrease) in Meter set deposits	25,857	11,830
Increase (decrease) in Taxes and insurance	(3,243)	(5,075)
Net cash provided (used) in operating activities	\$ (1,991,669)	\$ (1,145,939)

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

WESTERN HILLS WATER DISTRICT  
Notes to Financial Statements  
June 30, 2016 and 2015

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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. 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 \$38,505,000. In July 2015 the 2005 bonds, with a balance of \$7,320,000, was refunded by the refunding of the 2015 Refunding Bond, \$7,260,000. 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, 2016 and 2015

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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.

Investments are carried at fair value. Fair value is based on quoted market price, if applicable, otherwise the fair value hierarchy is as follows.

WESTERN HILLS WATER DISTRICT  
Notes to Financial Statements  
June 30, 2016 and 2015

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1. Summary of Significant Accounting Policies (continued)

Investments (continued)

Level 1 – Values are unadjusted quoted prices in active markets for identical assets or liabilities at the measurement date.

Level 2 –Inputs – other than quoted prices – included within Level 1 that are observable for the asset or liability, either directly or indirectly.

Level 3 – Certain inputs are unobservable inputs (supported by little or no market activity), such as the District's best estimate of what hypothetical market participants would use to determine a transaction price for the asset or liability at the reporting date.

Additional cash and investment disclosures are presented in Note 2. All of the District's investments are considered Level 1.

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.

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.

WESTERN HILLS WATER DISTRICT  
Notes to Financial Statements  
June 30, 2016 and 2015

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1. Summary of Significant Accounting Policies (continued)

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, Expenses and Changes in Net Position. 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, 2016 or 2015). 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 GASB Pronouncements

Statement No. 79 – *Certain External Investment Pools and Pool Participants*

Statement No. 76 - *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments.*

Statement No. 73 – *Accounting and Financial Reporting for Pensions and Related Assets That are Not within the scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68.*

Statement No. 72 – *Fair Value Measurement and Application.*

Statement No. 77 – *Tax Abatement Disclosure*



WESTERN HILLS WATER DISTRICT  
Notes to Financial Statements  
June 30, 2016 and 2015

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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 one institution at June 30, 2016, and exceeded the FDIC insured amount of \$250,000 by \$5,775,397.

The June 30, 2016, investments in the US Treasury Money Market Trust of \$4,589,144 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.

<u>Investment Type</u>	<u>Fair Value</u>	<u>Minimum Not Required</u>		<u>Rating as of Year End</u>		
		<u>Legal Rating</u>	<u>To Be Rated</u>	<u>AAA</u>	<u>A</u>	<u>Unrated</u>
US Treasury Money Market	\$ 4,589,144	N/A	\$ 4,589,144	\$ -	\$ -	\$ -

Restricted Cash

Cash in the amount \$5,820,586 has been restricted by loan agreements for the payment of loan debt service.

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WESTERN HILLS WATER DISTRICT  
Notes to Financial Statements  
June 30, 2016 and 2015

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, 2016:

	Balance <u>June 30, 2015</u>	Reclassifications & Additions	Balance <u>June 30, 2016</u>	Depreciable <u>Life in Years</u>
Water treatment facilities	\$11,463,452	\$ 223,856	\$11,687,308	40
Water treatment equipment	98,349	(4,279)	94,070	3 to 5
Pump station & well	3,057,844	49,643	3,107,487	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	43,127	11,170	54,297	3 to 40
	<u>44,765,539</u>	<u>230,747</u>	<u>44,996,286</u>	
Accumulated depreciation	<u>14,181,989</u>	<u>1,223,097</u>	<u>15,405,086</u>	
Net book value	<u>\$30,583,550</u>	<u>\$ (992,350)</u>	<u>\$29,591,200</u>	
Construction in progress	<u>\$10,638,249</u>	<u>\$ 255,476</u>	<u>\$10,893,725</u>	n/a

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

Refunding Revenue Bonds - 2015

In August 2015, the District issued \$7,260,000 of Refunding Revenue Bonds with interest rates ranging from 2.250% to 4.750%. The Bonds are secured by a pledge of special tax revenue. Principle payments are due annually on September 1, and interest is payable semi-annually on September 1 and March 1.

The District issued the 2015 Refunding Revenue Bonds to advance refund the 2005 Revenue Installment Certificates, which had interest rates of 4.650% to 5.800%. 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 2005 debt was removed from the District's accounts. The 2005 debt issues no longer have any outstanding balance.

WESTERN HILLS WATER DISTRICT  
Notes to Financial Statements  
June 30, 2016 and 2015

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

Refunding Revenue Bonds – 2015 (continued)

Total costs of the 2015 Refunding Revenue Bonds recognized as non-operating expense for the fiscal year ended June 30, 2016 was \$421,409, including an original issue discount of \$105,540.

The District completed the 2015 refunding of the 2005 special tax bonds to reduce its total debt service (net of the costs of the refunding) over 16 years by \$550,121 and to obtain an economic gain of \$511,370. 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 2015 Refunding Revenue Bonds of 4.46%.

Refunding Revenue Bonds – 2014

In August 2014, the District issued \$38,505,000 of Refunding Revenue Bonds with interest rates ranging from 2.0% to 5.3%. 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.

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, 2015 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%.

WESTERN HILLS WATER DISTRICT  
Notes to Financial Statements  
June 30, 2016 and 2015

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

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

	Year Ended <u>June 30, 2016</u>	Year Ended <u>June 30, 2015</u>
Balance at beginning of year	\$ 45,770,000	\$ 46,290,000
New issuance- bond refunding	7,260,000	38,505,000
Bond retirements	(7,320,000)	(38,710,000)
Principal payments	-	(315,000)
Balance at end of year	<u>\$ 45,710,000</u>	<u>\$ 45,770,000</u>
Due in one year	<u>\$ 475,000</u>	<u>\$ 275,000</u>

Debt Schedules

The following are debt service schedules to maturity:

Fiscal Year Ending June 30,	<u>2014 Bond</u>		
	Interest	Principal	Total
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
2021	1,588,510	2,050,000	3,638,510
Thereafter	<u>9,508,448</u>	<u>30,170,000</u>	<u>39,678,448</u>
	<u>\$ 18,123,948</u>	<u>\$ 38,450,000</u>	<u>\$ 56,573,948</u>

WESTERN HILLS WATER DISTRICT  
Notes to Financial Statements  
June 30, 2016 and 2015

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>2015 Bond</u>			
Fiscal Year Ending June 30,	Interest	Principal	Total
2017	\$ 306,650	\$ -	306,650
2018	301,650	200,000	501,650
2019	287,150	380,000	667,150
2020	270,400	400,000	670,400
2021	255,538	420,000	675,538
Thereafter	<u>1,517,328</u>	<u>5,860,000</u>	<u>7,377,328</u>
	<u>\$ 2,938,716</u>	<u>\$ 7,260,000</u>	<u>\$ 10,198,716</u>

<u>All Bonds</u>			
Fiscal Year Ending June 30,	Interest	Principal	Total
2017	\$ 2,133,310	\$ 475,000	\$ 2,608,310
2018	2,095,660	2,060,000	4,155,660
2019	2,024,460	2,300,000	4,324,460
2020	1,939,410	2,375,000	4,314,410
2021	1,844,048	2,470,000	4,314,048
Thereafter	<u>11,025,776</u>	<u>36,030,000</u>	<u>47,055,776</u>
	<u>\$ 21,062,664</u>	<u>\$ 45,710,000</u>	<u>\$ 66,772,664</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, 2016:

- (a) 10% of the original principal: \$4,576,500
- (b) 100% of the maximum annual debt service on the bonds based on years ended September 1:  
\$4,373,266
- (c) 125% of the average annual debt service: \$5,303,193

WESTERN HILLS WATER DISTRICT  
Notes to Financial Statements  
June 30, 2016 and 2015

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

Reserve fund (continued)

The purpose of this \$4,373,266 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.

The remaining proceeds of the bond issue after allowing for costs of issuance were set aside to reimburse improvement costs.

At June 30, 2016, the reserve requirements were as follows:

Reserve Fund- 2014 Bond	\$ 3,686,110
Reserve Fund- 2015 Bond	687,156
Total reserve requirement	<u>\$ 4,373,266</u>
Funds set aside for debt service at June 30, 2016	<u>\$ 4,589,144</u>

The indebtedness will be retired over a seventeen-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%.

WESTERN HILLS WATER DISTRICT  
Notes to Financial Statements  
June 30, 2016 and 2015

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5. Caterpillar Note Payable (continued)

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
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
2021	40,636	410,494	451,130
Thereafter	<u>13,148</u>	<u>400,125</u>	<u>413,273</u>
	<u>\$ 458,415</u>	<u>\$ 2,210,508</u>	<u>\$ 2,668,923</u>

6. Operating Deficit

The District's assets are substantially in place as of June 30, 2016. However, the operations including water revenue will not be fully realized until the development is completed. At June 30, 2016, 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.

At June 30, 2016, the District's deficit net position was \$(13,987,538).

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, 2016 and 2015, the entire balance due from Diablo Grande LP had been written off due to its bankruptcy.

World International LLC – the successor Developer acquired the property contained in the District through the bankruptcy proceedings of Diablo Grande LP. As of June 30, 2016 and 2015, advances payable to World International LLC were \$13,475,995 and \$11,180,995, respectively.

WESTERN HILLS WATER DISTRICT  
Notes to Financial Statements  
June 30, 2016 and 2015

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8. Payables Concentration

Of the total accounts payable balance of \$4,070,316 and \$4,089,971 at June 30, 2016 and 2015, respectively, \$4,000,626 was a delinquent account payable to Veolia Water in both years. As of June 12, 2017, Veolia Water has not pursued any litigation to collect the delinquent balance due from the District.

9. Going Concern

Continued operating losses coupled with the bankruptcy of the former 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.

10. Development Expenses

During the year the District expended \$435,000 of the Diablo Grande Community Facilities District No. 1 Mello Roos taxes on the purchase and installation of emergency communications equipment for the Diablo Grande development. The equipment was a contribution made as permitted by the Western Hills Water District Resolution No. 2000-06 (see Exhibit A of the resolution).

11. Subsequent Events

Subsequent events have been evaluated through June 12, 2017, which is the date the financial statements were available to be issued.





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REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE  
AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED  
IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

The Board of Directors  
Western Hills Water District

We have audited, 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, the financial statements of the business-type activities of Western Hills Water District (the "District") as of and for the year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the District's basic financial statements, and have issued our report thereon dated June 30, 2016.

***Internal Control over Financial Reporting***

In planning and performing our audit of the financial statements, we considered the District's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control. Accordingly, we do not express an opinion on the effectiveness of the District's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the letter to the Board of Directors dated June 12, 2017, we identified certain deficiencies in internal control that we consider to be material weaknesses.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the letter to the Board of Directors dated June 12, 2017 to be material weaknesses.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

## Compliance and Other Matters


As part of obtaining reasonable assurance about whether the District's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

## Western Hill Water District's Response to Findings

Western Hill Water District's response to the findings identified in our audit are described in the letter to the Board of Directors dated June 12, 2017.

## Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

  
CROPPER ACCOUNTANCY CORPORATION  
Walnut Creek, California  
June 12, 2017