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**WESTERN HILLS WATER DISTRICT**

**FINANCIAL STATEMENTS**

**JUNE 30, 2017 and 2016**

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## INDEPENDENT AUDITORS' REPORT

To the Board of Directors  
Western Hills Water District

### **Report on the Financial Statements**

We have audited the accompanying financial statements of the business-type activities of Western Hills Water District (the District), as of and for the year ended June 30, 2017 and 2016, and the related notes to the financial statements, which collectively comprise the District's basic financial statements as listed in the table of contents.

#### ***Management's Responsibility for the Financial Statements***

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 statement 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 auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

#### ***Opinion***

In our opinion, the financial statements referred to above present fairly, in all material respects, the business-type activities of Western Hills Water District, as of June 30, 2017 and 2016, 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.

## *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 3 – 7) 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*  
CROPPER ACCOUNTANCY CORPORATION

Walnut Creek, California

December 22, 2017

**Western Hills Water District  
Management's Discussion and Analysis  
For the year ended June 30, 2017**

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, 2017. Please read it in conjunction with the Basic Financial Statements, which follow this section.

**FINANCIAL HIGHLIGHTS**

- The District's total assets increased by \$1,210,259, or 2.3%, to \$53.51 million.
- During the year the District's operating revenue increased by 23.9% to \$2.56 million, while operating expenses decreased by 2.7% to \$4.42 million.
- Due to the 2016 Refunding of the 2005 Special Tax Bonds, bond-related expenses decreased from \$421 thousand to \$16 thousand. This was partially offset by a \$46 thousand increase in interest expense.
- Net position increased by \$384 thousand to \$(13.60) 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, 2017**

**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 increased by \$384 thousand to \$(13.60) million in fiscal year 2017. This decrease is a result of the following:

1. Assets increased by \$1.21 million, primarily due the bond refinance and money made available for capital projects along with the depreciation of fixed assets.
2. Liabilities increased by \$827 thousand, due to a \$1.23 million increase in advances from World International and by a \$667 thousand decrease in the bonds payable and long-term debt (including the current portion).

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

	<b>2017</b>	<b>2016</b>
Current Assets	\$ 7,764	\$ 7,225
Restricted Assets	4,587	4,589
Fixed Assets	41,158	40,485
<b>Total Assets</b>	<b>53,509</b>	<b>52,299</b>
Current Liabilities	22,278	19,157
Long-Term Debt	44,835	47,129
<b>Total Liabilities</b>	<b>67,113</b>	<b>66,286</b>
<b>Net Position</b>	<b>\$ (13,604)</b>	<b>\$ (13,987)</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 2017's challenges at the end of this report.

**Western Hills Water District  
Management's Discussion and Analysis  
For the year ended June 30, 2017**

**TABLE 2  
Statement of Revenues and Expenses  
For the Years ended June 30, 2017 and 2016  
(in thousands)**

	<u>2017</u>	<u>2016</u>	<b>Total % Change Fav/(Unfav)</b>
Total Operating Revenues	\$ 2,557	\$ 2,064	23.9%
Total Operating Expenses (less depreciation)	<u>3,189</u>	<u>3,320</u>	<u>(3.9%)</u>
<b>Net Operating Loss Before Depreciation</b>	<b><u>\$ (632)</u></b>	<b><u>\$ (1,256)</u></b>	<b><u>49.7%</u></b>

**CAPITAL ASSETS**

During 2017, the District had \$385 thousand of additional investment in the new water treatment system.

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

	<u>2017</u>	<u>2016</u>	<b>Dollar Change</b>	<b>Total % Change</b>
Land	\$ 782	\$ -	\$ 782	-
Water Treatment Facilities/Equipt	11,773	11,781	(8)	(0.07%)
Pump Station & Well	3,389	3,107	282	9.08%
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	11,603	10,894	709	6.51%
Vehicles	150	-	150	-
Other	<u>54</u>	<u>65</u>	<u>(11)</u>	<u>(16.92%)</u>
<b>Subtotal</b>	<b><u>57,794</u></b>	<b><u>55,890</u></b>	<b><u>1,904</u></b>	<b><u>3.41%</u></b>
Less Accumulated Depreciation	<u>16,636</u>	<u>15,405</u>	<u>1,231</u>	<u>7.99%</u>
<b>Net Book Value</b>	<b><u>\$ 41,158</u></b>	<b><u>\$ 40,485</u></b>	<b><u>\$ 673</u></b>	<b><u>1.66%</u></b>

**LONG TERM DEBT**

At year-end, the District had \$47.25 million in long-term debt (including the current portion). This is a net decrease of \$667 thousand from 2016, due to bond and note payments made during the year.

**Western Hills Water District  
Management's Discussion and Analysis  
For the year ended June 30, 2017**

The District has outstanding general obligation debt stemming from Mello-Roos bonds issued in January 2005 and the 2016 Refunding Bonds issued in July of 2016. The District's current average cost of capital is 4.40% on outstanding debt, as shown on Table 4.

**TABLE 4  
Outstanding Debt**

	<u>Debt Balance</u>	<u>Average Rate</u>
General Obligation Bonds	\$ 42,235	4.34%
Notes Payable	\$ 2,019	6.61%

**2018 CHALLENGES AND A LOOK AT THE FUTURE:**

Western Hills Water District's assets are notably in place as of June 30, 2017.

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

Upgrades: There will be additional capital expenditures in 2017 – 2018 funded by proceeds from the refinancing of the bonds in 2014 and 2016.

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 2017 the new pumps have been installed and the four new 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.

In April 2017 a sewer rate study and increase proposal was sent to residents of Diablo Grande. Sewer increases are subject to the same Proposition 218 regulations as water increases. The subsequent increase was voted down also. This increase proposal was a pass through to cover the charges paid to the City of Patterson (COP). No additional dollars were proposed to cover any overhead. As of July 1, 2017, the District will pay \$66.66/month per house. Because of the defeat of the proposed increase the District will lose \$10.69/month per house resulting in a yearly loss of \$60,000, increasing annually as the charge from the COP will increase annually.

Additionally, the Developer has expressed reluctance to continue funding the District's losses.



**Western Hills Water District  
Management's Discussion and Analysis  
For the year ended June 30, 2017**

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 2017 the District was allotted 85%, of the total 8,000 acre feet, and therefore received \$1.05 million 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.

**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, 2017 and 2016

	2017	2016
<b><u>ASSETS</u></b>		
Current Assets		
Cash (Note 2)	\$ 661,354	\$ 135,791
Restricted cash (Note 2)	6,058,352	5,820,586
Accounts receivable	311,082	68,891
Prepaid water charges	718,463	531,392
Other prepaid expenses	-	5,836
Accounts receivable water banking	-	659,688
Meter inventory	14,574	2,400
Total current assets	7,763,825	7,224,584
Assets restricted for debt service, at current values		
Federated money market trust		
U.S. Treasury Obligations (Note 2)	4,586,919	4,589,144
Total restricted assets	4,586,919	4,589,144
Fixed Assets, net of accumulated depreciation of \$16,636,060 and \$15,405,086 for 2017 and 2016, respectively (Note 3)	29,554,720	29,591,200
Construction in progress (Note 3)	11,603,448	10,893,725
Total assets	53,508,912	52,298,653
<b><u>LIABILITIES</u></b>		
Current Liabilities		
Accounts payable (Note 8)	4,336,014	4,070,316
Advances payable to World International LLC (Note 7)	14,709,995	13,475,995
Accrued interest payable	709,520	712,687
Customer deposits	96,829	104,187
Other current liabilities	6,407	2,498
Current portion of notes payable (Note 5)	358,805	316,755
Current portion of bonds payable (Note 4)	2,060,000	475,000
Total current liabilities	22,277,570	19,157,438
Notes payable, net of current portion (Note 5)	1,660,154	1,893,753
Bonds payable, net of current portion (Note 4)	43,175,000	45,235,000
Total liabilities	67,112,724	66,286,191
<b><u>NET POSITION</u></b>		
Invested in capital assets, net of related debt	(6,095,791)	(7,435,583)
Restricted for bond reserve funds	4,373,266	4,373,266
Unrestricted	(11,881,287)	(10,925,221)
Total net position (Note 6)	\$ (13,603,812)	\$ (13,987,538)

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, 2017 and 2016

	2017	2016
Operating Revenue		
Water revenue		
Residential	\$ 725,701	\$ 552,610
Commercial	47,871	83,831
Golf course	310,251	352,725
Water banking program	1,053,649	669,000
Sewer and stormdrain	378,385	300,722
Construction	175	-
Winery	6,495	6,924
Other	34,647	98,272
Total operating revenues	2,557,174	2,064,084
Operating Expenses		
Labor and related expenses	433,478	488,832
Purchased water	1,249,856	1,414,684
Waste water hauling and disposal	377,644	310,325
Water treatment	294,522	283,944
Utilities/fuel for pump	183,703	206,090
Maintenance	170,575	131,232
Contractual services	228,845	215,664
Insurance	73,383	61,487
Licenses and fees	4,100	3,925
General and administrative	144,954	203,878
Depreciation	1,231,474	1,223,097
Other	27,941	-
Total operating expenses	4,420,475	4,543,158
Operating loss	(1,863,301)	(2,479,074)
Non-Operating Revenue (Expenses)		
Property taxes	4,451,607	4,405,892
Investment income	38,699	15,290
Other income	81,608	80,408
Interest on bonded indebtedness	(2,164,222)	(2,117,761)
Other interest expense	(144,601)	(154,390)
Bond related expense	(16,064)	(421,409)
Development expenses	-	(435,000)
Total non-operating revenues (expenses)	2,247,027	1,373,030
Change in net position	383,726	(1,106,044)
Net position at beginning of year	(13,987,538)	(12,881,494)
Total net position at end of year	\$ (13,603,812)	\$ (13,987,538)

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

WESTERN HILLS WATER DISTRICT  
Statements of Cash Flows  
June 30, 2017 and 2016

	2017	2016
Cash flows from operating activities		
Receipts from customers and users	\$ 2,967,313	\$ 1,446,885
Payments to suppliers of goods and services	(2,667,151)	(2,949,722)
Payments to employees and related benefits	(433,478)	(488,832)
Net cash provided (used) in operating activities	(133,316)	(1,991,669)
Cash flows from capital and related financing activities		
Bond indebtedness retired	(475,000)	(7,320,000)
Bond refunding proceeds	-	7,260,000
Payments on Caterpillar loan	(191,549)	(296,746)
Fixed asset additions, including construction in progress	(1,904,717)	(486,223)
Interest paid on bonded indebtedness	(2,167,389)	(2,195,821)
Other interest paid	(144,601)	(154,390)
Bond related expenses	(16,064)	(421,409)
Development expenses	-	(435,000)
Advances received from developer	1,234,000	2,295,000
Property taxes collected for debt	4,451,607	4,405,892
Recovery of bond costs	81,608	80,408
Net provided (used) in capital and financing activities	867,895	2,731,711
Cash flows from investing activities		
Proceeds from sales of investments	2,225	1,396,880
Investment income received	38,699	15,290
Purchase of meter inventory	(12,174)	-
Net cash provided (used) in investing activities	28,750	1,412,170
Net increase (decrease) in cash	763,329	2,152,212
Cash at beginning of year	5,956,377	3,804,165
Cash at end of year	\$ 6,719,706	\$ 5,956,377
Reconciliation of Operating Loss to Net Cash		
Provided by Operating Activities:		
Net operating loss	\$ (1,863,301)	\$ (2,479,074)
Adjustments to cash used in operating activities:		
Depreciation expense	1,231,474	1,223,097
(Increase) decrease in Accounts receivable	(242,191)	16,632
(Increase) decrease in Prepaid water charges	(187,071)	(89,759)
(Increase) decrease in Prepaid expenses	5,836	(5,836)
(Increase) decrease in Accounts receivable water banking	659,688	(659,688)
Increase (decrease) in Accounts payable	265,698	(19,655)
Increase (decrease) in Meter set deposits	(7,358)	25,857
Increase (decrease) in Taxes and insurance	3,909	(3,243)
Net cash provided (used) in operating activities	\$ (133,316)	\$ (1,991,669)

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

WESTERN HILLS WATER DISTRICT  
Notes to Financial Statements  
June 30, 2017 and 2016

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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, 2017 and 2016

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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, 2017 and 2016

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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, 2017 and 2016

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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, 2017 or 2016). 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

In November 2016, the Governmental Accounting Standards Board (GASB) issued Statement No. 83, *Certain Asset Retirement Obligations* (GASB No. 83). GASB No. 83 addresses accounting and financial reporting for certain asset retirement obligations (AROs). An ARO is a legally enforceable liability associated with the retirement of a tangible capital asset. A government that has legal obligations to perform future asset retirement activities related to its tangible capital assets should recognize a liability based on the guidance in GASB No. 83.

GASB No. 83 will enhance comparability of financial statements among governments by establishing uniform criteria for governments to recognize and measure certain AROs, including obligations that may not have been previously reported. GASB No. 83 will enhance the decision-usefulness of the information provided to financial statement users by requiring disclosures related to those AROs. The requirements of GASB No. 83 are effective for reporting periods beginning after June 15, 2018. The District does not believe that there will be any financial statement effect related to GASB No. 83.



WESTERN HILLS WATER DISTRICT  
Notes to Financial Statements  
June 30, 2017 and 2016

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1. Summary of Significant Accounting Policies (continued)

New GASB Pronouncements (continued)

In January 2017 GASB issued Statement No. 84, *Fiduciary Activities* (GASB No. 84). The objective of which is to improve guidance regarding the identification of fiduciary activities for accounting and financial reporting purposes and how those activities should be reported. The requirements of GASB No. 84 will enhance consistency and comparability by (1) establishing specific criteria for identifying activities that should be reported as fiduciary activities and (2) clarifying whether and how business-type activities should report their fiduciary activities. The requirements of GASB No. 84 are effective for reporting periods beginning after December 15, 2018. The District does not believe that there will be any financial statement effect related to GASB No. 84.

In March 2017, GASB issued Statement No. 85, *Omnibus 2017* (GASB No. 85). The objective of this Statement is to address practice issues that have been identified during implementation and application of certain GASB Statements. GASB No. 85 addresses a variety of topics including issues related to blending component units, goodwill, fair value measurement and application, and postemployment benefits (pensions and other postemployment benefits [OPEB]). Specifically, the following topics are addressed:

- Blending a component unit in circumstances in which the primary government is a business-type activity that reports in a single column for financial statement presentation
- Reporting amounts previously reported as goodwill and "negative" goodwill
- Classifying real estate held by insurance entities
- Measuring certain money market investments and participating interest-earning investment contracts at amortized cost
- Timing of the measurement of pension or OPEB liabilities and expenditures recognized in financial statements prepared using the current financial resources measurement focus
- Recognizing on-behalf payments for pensions or OPEB in employer financial statements
- Presenting payroll-related measures in required supplementary information for purposes of reporting by OPEB plans and employers that provide OPEB
- Classifying employer-paid member contributions for OPEB
- Simplifying certain aspects of the alternative measurement method for OPEB
- Accounting and financial reporting for OPEB provided through certain multiple-employer defined benefit OPEB plans.

The requirements of GASB No. 85 are effective for reporting periods beginning after June 15, 2017. The District does not believe that there will be any financial statement effect related to the GASB No. 85.

WESTERN HILLS WATER DISTRICT  
Notes to Financial Statements  
June 30, 2017 and 2016

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1. Summary of Significant Accounting Policies (continued)

New GASB Pronouncements (continued)

In May 2017, GASB issued Statement No. 86, *Certain Debt Extinguishment Issues* (GASB No. 86). The primary objective of GASB No. 86 is to improve consistency in accounting and financial reporting for in-substance defeasance of debt by providing guidance for transactions in which cash and other monetary assets acquired with only existing resources-resources other than the proceeds of refunding debt-are placed in an irrevocable trust for the sole purpose of extinguishing debt. GASB No. 86 also improves accounting and financial reporting for prepaid insurance on debt that is extinguished and notes to financial statements for debt that is defeased in substance. The requirements of GASB No. 86 are effective for reporting periods beginning after June 15, 2017. The District does not believe that there will be any financial statement effect related to GASB No. 86.

In June 2017, GASB issued Statement No. 87, *Leases* (GASB No. 87). The objective of GASB No. 87 is to better meet the information needs of financial statement users by improving accounting and financial reporting for leases by governments. GASB No. 87 increases the usefulness of governments' financial statements by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. Under GASB No. 87, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources, thereby enhancing the relevance and consistency of information about governments' leasing activities.

GASB No. 87 will increase the usefulness of governments' financial statements by requiring reporting of certain lease liabilities that currently are not reported. It will enhance comparability of financial statements among governments by requiring lessees and lessors to report leases under a single model. GASB No. 87 also will enhance the decision-usefulness of the information provided to financial statement users by requiring notes to financial statements related to the timing, significance, and purpose of a government's leasing arrangements.

The requirements of GASB No. 87 are effective for reporting periods beginning after December 15, 2019. The District has not assessed the financial statement effect related to GASB No. 87.

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WESTERN HILLS WATER DISTRICT  
Notes to Financial Statements  
June 30, 2017 and 2016

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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, 2017, and exceeded the FDIC insured amount of \$250,000 by \$6,550,378.

Cash and cash equivalents consist of the following:

	<u>June 30, 2017</u>	<u>June 30, 2016</u>
Cash	\$ 661,354	\$ 135,791
Restricted cash	6,058,352	5,820,586
Total cash	<u>\$ 6,719,706</u>	<u>\$ 5,956,372</u>

The June 30, 2017, investments in the US Treasury Money Market Trust of \$4,586,919 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	<u>\$ 4,586,919</u>	N/A	<u>\$ 4,586,919</u>	\$ -	\$ -	\$ -

Restricted Cash

Cash in the amount \$6,058,352 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, 2017 and 2016

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, 2017:

	Balance <u>June 30, 2016</u>	Reclassifications & Additions	Balance <u>June 30, 2017</u>	Depreciable <u>Life in Years</u>
Land	\$ -	\$ 782,393	\$ 782,393	n/a
Water treatment facilities	11,687,308	-	11,687,308	40
Water treatment equipment	94,070	(7,822)	86,248	3 to 5
Pump station & well	3,107,487	281,426	3,388,913	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
Frog pond	10,803	-	10,803	30
Vehicles	-	149,667	149,667	5
Other	54,297	(11,170)	43,127	3 to 40
	<u>44,996,286</u>	<u>1,194,494</u>	<u>46,190,780</u>	
Accumulated depreciation	<u>15,405,086</u>	<u>1,230,974</u>	<u>16,636,060</u>	
Net book value	<u>\$29,591,200</u>	<u>\$ (36,480)</u>	<u>\$29,554,720</u>	
Construction in progress	<u>\$10,893,725</u>	<u>\$ 709,723</u>	<u>\$11,603,448</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, 2017 and 2016

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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%.

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WESTERN HILLS WATER DISTRICT  
Notes to Financial Statements  
June 30, 2017 and 2016

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, 2017</u>	Year Ended <u>June 30, 2016</u>
Balance at beginning of year	\$ 45,710,000	\$ 45,770,000
New issuance- bond refunding	-	7,260,000
Bond retirements	(475,000)	(7,320,000)
Principal payments	-	-
Balance at end of year	<u>\$ 45,235,000</u>	<u>\$ 45,710,000</u>
Due in one year	<u>\$ 2,060,000</u>	<u>\$ 475,000</u>

Debt Schedules

The following are debt service schedules to maturity:

Fiscal Year Ending June 30,	<u>2014 Bond</u>		
	Interest	Principal	Total
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
2022	1,505,010	2,125,000	3,630,010
Thereafter	<u>8,003,438</u>	<u>28,045,000</u>	<u>36,048,438</u>
	<u>\$ 16,297,288</u>	<u>\$ 37,975,000</u>	<u>\$ 54,272,288</u>

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WESTERN HILLS WATER DISTRICT  
Notes to Financial Statements  
June 30, 2017 and 2016

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
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
2022	240,041	435,000	675,041
Thereafter	<u>1,277,287</u>	<u>5,425,000</u>	<u>6,702,287</u>
	<u>\$ 2,632,066</u>	<u>\$ 7,260,000</u>	<u>\$ 9,892,066</u>

<u>All Bonds</u>			
Fiscal Year Ending June 30,	Interest	Principal	Total
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
2022	1,745,051	2,560,000	4,305,051
Thereafter	<u>9,280,725</u>	<u>33,470,000</u>	<u>42,750,725</u>
	<u>\$ 18,929,354</u>	<u>\$ 45,235,000</u>	<u>\$ 64,164,354</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, 2017:

- (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: \$5,435,719

WESTERN HILLS WATER DISTRICT  
Notes to Financial Statements  
June 30, 2017 and 2016

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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, 2017, the reserve requirements were as follows:

Reserve Fund- 2014 Bond	\$ 3,686,110
Reserve Fund- 2015 Bond	<u>687,156</u>
Total reserve requirement	<u>\$ 4,373,266</u>
Funds set aside for debt service at June 30, 2017	<u>\$ 4,586,919</u>

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

5. Notes 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%.

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WESTERN HILLS WATER DISTRICT  
Notes to Financial Statements  
June 30, 2017 and 2016

5. Notes 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
2018	113,164	337,965	451,130
2019	90,534	360,596	451,130
2020	66,558	384,572	451,130
2021	40,636	410,494	451,130
2022	13,148	400,416	413,564
	<u>\$ 324,041</u>	<u>\$ 1,894,043</u>	<u>\$ 2,218,084</u>

In October 2016, the District entered into three note agreements for the purchase of three Dodge Ram 1500 trucks. The total amount borrowed under these agreements of \$138,997 is payable in sixty to seventy-two equal monthly installments at annual interest rates ranging from 8.72% to 10.42%.

The following is the debt service schedule to maturity for the three Dodge Ram notes payable:

Fiscal Year Ending June 30,	Interest	Principal	Total
2018	\$ 11,155	\$ 20,840	\$ 31,995
2019	9,070	22,925	31,995
2020	6,776	25,219	31,995
2021	4,250	27,745	31,995
2022	1,644	23,360	25,004
Thereafter	77	4,827	4,904
	<u>\$ 32,972</u>	<u>\$ 124,916</u>	<u>\$ 157,888</u>

All Notes

Fiscal Year Ending June 30,	Interest	Principal	Total
2018	\$ 124,320	\$ 358,805	\$ 483,125
2019	99,604	383,521	483,125
2020	73,334	409,791	483,125
2021	44,886	438,239	483,125
2022	14,792	423,776	438,568
Thereafter	77	4,827	4,904
	<u>\$ 357,013</u>	<u>\$ 2,018,959</u>	<u>\$ 2,375,972</u>

WESTERN HILLS WATER DISTRICT  
Notes to Financial Statements  
June 30, 2017 and 2016

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6. Operating Deficit

The District's assets are substantially in place as of June 30, 2017. However, the operations including water revenue will not be fully realized until the development is completed. At June 30, 2017, 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, 2017, the District's deficit net position was \$(13,603,812).

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, 2017 and 2016, 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, 2017 and 2016, advances payable to World International LLC were \$14,709,995 and \$13,475,995, respectively.

8. Payables Concentration

Of the total accounts payable balance of \$4,336,014 and \$4,070,316 at June 30, 2017 and 2016, respectively, \$4,000,626 was a delinquent account payable to Veolia Water in both years. As of December 18, 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.

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WESTERN HILLS WATER DISTRICT  
Notes to Financial Statements  
June 30, 2017 and 2016

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10. Development Expenses

During the year ended June 30, 2016, 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

Management has evaluated subsequent events through the date of the audit opinion letter, 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 Western Hills Water District as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise Western Hills Water District's basic financial statements, and have issued our report thereon dated December 22, 2017.

***Internal Control over Financial Reporting***

In planning and performing our audit of the financial statements, we considered Western Hills Water 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 Western Hills Water District's internal control. Accordingly, we do not express an opinion on the effectiveness of Western Hills Water 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 December 22, 2017, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

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, numbered 1 and 2, described in the letter to the Board of Directors dated December 22, 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 Western Hills Water 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 Hills Water District's Response to Findings**

Western Hills Water District's response to the findings identified in our audit are described in the letter to the Board of Directors dated December 22, 2017. Western Hills Water District's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

### **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  
December 22, 2017