



WESTERN HILLS WATER DISTRICT

FINANCIAL STATEMENTS

JUNE 30, 2018 and 2017

TABLE OF CONTENTS

	<u>Page No.</u>
Independent Auditors' Report	1 – 2
Management's Discussion and Analysis	3 – 7
Statements of Net Position	8
Statements of Revenues, Expenses and Changes in Net Position Whwd1	9
Statements of Cash Flows	10
Notes to Financial Statements	11 – 26
Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	27 – 28



2700 Ygnacio Valley Road, Ste 270
Walnut Creek, CA 94598
(925) 932-3860 tel
(925) 476-9930 efax
www.cropperaccountancy.com

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 the Western Hills Water District as of and for the year ended June 30, 2018 and 2017, 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

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.

Auditors' 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of Western Hills Water District, as of June 30, 2018 and 2017 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. However, as discussed in Note 6 to the financial statements, the District's operating results and negative net position balance raise substantial doubt about the District's ability to continue as a going concern.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated March 22, 2019, on our consideration of Western Hills Water District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of Western Hills Water District's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Western Hills Water District's internal control over financial reporting and compliance.


CROPPER ACCOUNTANCY CORPORATION
Walnut Creek, California
March 22, 2019

**Western Hills Water District
Management's Discussion and Analysis
For the year ended June 30, 2018**

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, 2018. Please read it in conjunction with the Basic Financial Statements, which follow this section.

FINANCIAL HIGHLIGHTS

- The District's total assets decreased by \$4,271,336, or 8.0%, to \$49.24 million.
- During the year the District's operating revenue decreased by 20.0% to \$2.05 million, while operating expenses increased by 6.0% to \$4.68 million.
- Due to the 2015 Refunding of the 2005 Special Tax Bonds, bond-related expenses increased from \$16 thousand to \$17 thousand. This was partially offset by a \$46 thousand increase in interest expense.
- Net position decreased by \$2.77 million to \$(16.37) 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, 2018**

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 \$2.77 million to \$(16.37) million in fiscal year 2018. This decrease is a result of the following:

1. Assets decreased by \$4.27 million, due to money being made available for capital projects along with the depreciation of fixed assets.
2. Liabilities decreased by \$1.51 million, due to a \$2.7 million decrease in long-term debt offset by a \$1.2 million increase in current liabilities.

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

	2018	2017
Current Assets	\$ 4,731	\$ 7,764
Restricted Assets	4,444	4,587
Fixed Assets	40,063	41,158
Total Assets	49,238	53,509
Current Liabilities	23,475	22,278
Long-Term Debt	42,132	44,835
Total Liabilities	65,607	67,113
Net Position	\$ (16,369)	\$ (13,604)

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 2018's challenges at the end of this report.

**Western Hills Water District
Management's Discussion and Analysis
For the year ended June 30, 2018**

**TABLE 2
Statement of Revenues and Expenses
For the Years ended June 30, 2018 and 2017
(in thousands)**

	<u>2018</u>	<u>2017</u>	Total % Change Fav/(Unfav)
Total Operating Revenues	\$ 2,053	\$ 2,557	(19.7%)
Total Operating Expenses (less depreciation)	3,434	3,189	7.7%
Net Operating Loss Before Depreciation	\$ (1,381)	\$ (632)	(118.5%)

CAPITAL ASSETS

During 2018, the District had \$154 thousand of additional investment in the new water treatment system.

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

	<u>2018</u>	<u>2017</u>	Dollar Change	Total % Change
Land	\$ 782	\$ 782	\$ -	0.00%
Water Treatment Facilities/Equipmt	11,775	11,773	2	0.02%
Pump Station & Well	3,389	3,389	-	0.00%
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	11,755	11,603	152	1.31%
Vehicles	150	150	-	0.00%
Other	54	54	-	0.00%
Subtotal	57,948	57,794	154	0.27%
Less Accumulated Depreciation	17,886	16,636	1,250	7.51%
Net Book Value	\$ 40,062	\$ 41,158	\$ (1,096)	(2.66)%

LONG TERM DEBT

At year-end, the District had \$44.82 million in long-term debt (including the current portion). This is a net decrease of \$2.44 million from 2017, 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, 2018**

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 4.89% on outstanding debt, as shown on Table 4.

**TABLE 4
Outstanding Debt**

	<u>Debt Balance</u>	<u>Average Rate</u>
General Obligation Bonds	\$ 43,155	4.34%
Notes Payable	\$ 1,660	17.31%

2018 CHALLENGES AND A LOOK AT THE FUTURE:

Western Hills Water District's assets are notably in place as of June 30, 2018.

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

Upgrades: Capital upgrades for 2017 – 2018 were put on hold until further notice.

Purchases: Capital expenditures for 2017 – 2018 were limited to \$201.4 thousand for the CIP WTP Expansion 2.

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

Setback: Water revenues have been held to a minor CIP increase per year. The water rate study that was performed in 2014 was defeated and there are no plans in 2019 to fund another study.

The district has the opportunity to sell excess water to five water districts but is limited to an allocation based on rain and snowfall. For 2017-2018 the district received 223.6 thousand in excess water revenue as the water allocation was 35%. Water expense for same time period was approximately 1 million.

Along with the water rate increase setback the district also incurred a rate increase setback for sewer expenses. The City of Patterson (COP) receives the districts sewer from a pipeline directly to their treatment facility. COP charges the district a rate that is 1.5 times the cities residential rate. In 2015 COP proposed a sewer service rate increase for the upcoming five years with increases each year. The first price increase took affect 12/2/2015. As the district is a customer of COP they are charged the rates approved/non- contested by city residents. Diablo Grande is considered rural.

The district proposed the new rates to the residents, of Diablo Grande, as a pass through and it was voted down. As of the year ended June 30, 2018 the district receives \$55.97/household per month and is charged 66.66/household per month. The rate from COP will be increasing to 70.67 for the 2018-2019 year. The district is subsidizing the sewer at a cost of 10.0 thousand/month to cover the COP monthly invoice.

**Western Hills Water District
Management's Discussion and Analysis
For the year ended June 30, 2018**

The district is planning on meeting with COP, in the upcoming year, but not optimistic as negotiations for better prices have been vetoed before.

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

Future: Capital purchase of 600 meters, transceiver hardware and laptop at a cost of \$176.0 thousand dollars. Cost of installation is quoted at 37.0 thousand. This is the only capital project slated for 2018-2019.

This project is an upgrade to our outdated meter reading system. Benefits will be less labor cost due to electronic capturing of monthly data for billing purposes. Including in this system is early warnings of excess usage or possible leakage of water. This will help to decrease our costs at the WTP due to less water lost.

Construction in progress (CIP): The district has 11,000.0 thousand in CIP that relates to a plant upgrade that is 85% completed. The district has put the final phase on hold until further notice. Therefore CIP has carried a higher than average balance over the last five years.

Developer Relationship: Developer has put the property up for sale. When this property is sold the new ownership will need to agree and adhere to the Master Agreement the district has with the developer. As of now the current owners are reluctant to fully fund the short falls of the district.

Going Concern: There will be a lot of hurdles in 2018-2019 fiscal year. Rising water treatment, sewer and personnel cost without revenue to cover will put an even more substantial burden on the developer.

As of June 30, 2018, the district owes the current developer 15,760.0 thousand. Until the district has enough housing and is self-sufficient there will not be any payments to 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
c/o Charles Smith, Financial Manager
9501 Morton Davis Drive #B
Diablo Grande, CA 95363-8610
Phone: (209) 895-9493 Fax: (209) 892-7845

WESTERN HILLS WATER DISTRICT
 Statements of Net Position
 June 30, 2018 and 2017

	2018	2017
<u>ASSETS</u>		
Current Assets		
Cash (Note 2)	\$ 880,834	\$ 661,354
Restricted cash (Note 2)	2,720,191	6,058,352
Accounts receivable	654,848	311,082
Prepaid water charges	465,708	718,463
Meter inventory	9,393	14,574
Other current assets	-	-
Total current assets	4,730,974	7,763,825
Assets restricted for debt service, at current values		
Federated money market trust		
U.S. Treasury Obligations (Note 2)	4,444,378	4,586,919
Total restricted assets	4,444,378	4,586,919
Fixed Assets, net of accumulated depreciation of \$17,885,721 and \$16,636,060 for 2018 and 2017, respectively (Note 3)		
Construction in progress (Note 3)	28,306,198	29,554,720
Total assets	49,237,576	53,508,912
<u>LIABILITIES</u>		
Current Liabilities		
Accounts payable (Note 8)	\$ 4,176,242	\$ 4,336,014
Advances payable to World International LLC (Note 7)	15,759,995	14,709,995
Accrued interest payable	712,655	709,520
Customer deposits	134,300	96,829
Other current liabilities	8,189	6,407
Current portion of FSC government loan (Note 5)	383,521	358,805
Current portion of bonds payable (Note 4)	2,300,000	2,060,000
Total current liabilities	23,474,902	22,277,570
Caterpillar FSC government loan, net of current portion (Note 5)	1,276,601	1,660,154
Bonds payable, net of current portion (Note 4)	40,855,000	43,175,000
Total liabilities	65,606,503	67,112,724
<u>NET POSITION</u>		
Invested in capital assets, net of related debt	(4,752,898)	(6,095,791)
Restricted for bond reserve funds (Note 4)	4,373,266	4,373,266
Unrestricted	(15,989,295)	(11,881,287)
Total net position (Note 6)	\$ (16,368,927)	\$ (13,603,812)

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, 2018 and 2017

	2018	2017
Operating Revenue		
Water revenue		
Residential	\$ 791,322	\$ 725,701
Commercial	7,149	47,871
Golf course	555,665	310,251
Water banking program	223,642	1,053,649
Sewer and stormdrain	380,921	378,385
Construction	(175)	175
Winery	7,777	6,495
Other	87,160	34,647
Total operating revenues	2,053,461	2,557,174
Operating Expenses		
Labor and related expenses	627,644	433,478
Purchased water	1,189,125	1,249,856
Waste water hauling and disposal	432,585	377,644
Water treatment	378,060	294,522
Utilities/fuel for pump	207,989	183,703
Maintenance	183,792	170,575
Contractual services	169,321	228,845
Insurance	39,499	73,383
Licenses and fees	4,250	4,100
General and administrative	182,018	144,954
Depreciation	1,249,661	1,231,474
Other	20,099	27,941
Total operating expenses	4,684,043	4,420,475
Operating loss	(2,630,582)	(1,863,301)
Non-Operating Revenue (Expenses)		
Property taxes	2,000,581	4,451,607
Investment income	64,574	38,699
Other income	82,108	81,608
Interest on bonded indebtedness	(2,141,423)	(2,164,222)
Other interest expense	(123,319)	(144,601)
Bond related expense	(17,054)	(16,064)
Total non-operating revenues (expenses)	(134,533)	2,247,027
Change in net position	(2,765,115)	383,726
Net position at beginning of year	(13,603,812)	(13,987,538)
Total net position at end of year	\$ (16,368,927)	\$ (13,603,812)

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

WESTERN HILLS WATER DISTRICT
Statements of Cash Flows
June 30, 2018 and 2017

	2018	2017
Cash flows from operating activities		
Receipts from customers and users	\$ 1,747,166	\$ 2,967,313
Payments to suppliers of goods and services	(2,711,973)	(2,667,151)
Payments to employees and related benefits	(627,644)	(433,478)
Net cash provided (used) in operating activities	(1,592,451)	(133,316)
Cash flows from capital and related financing activities		
Bond indebtedness retired	(2,080,000)	(475,000)
Payments on Caterpillar loan	(358,837)	(191,549)
Fixed asset additions, including construction in progress	(153,717)	(1,904,717)
Interest paid on bonded indebtedness	(2,138,288)	(2,167,389)
Other interest paid	(123,319)	(144,601)
Bond related expenses	(17,054)	(16,064)
Advances received from developer	1,050,000	1,234,000
Property taxes collected for debt	2,000,581	4,451,607
Recovery of bond costs	82,108	81,608
Net provided (used) in capital and financing activities	(1,738,526)	867,895
Cash flows from investing activities		
Proceeds from sales of investments	142,541	2,225
Investment income received	64,574	38,699
Sale of meter inventory	5,181	(12,174)
Net cash provided (used) in investing activities	212,296	28,750
Net increase (decrease) in cash	(3,118,681)	763,329
Cash at beginning of year	6,719,706	5,956,377
Cash at end of year	\$ 3,601,025	\$ 6,719,706
Presentation on Statement of Net Position		
Cash	\$ 880,834	\$ 661,354
Restricted Cash	2,720,191	6,058,352
Total Cash	\$ 3,601,025	\$ 6,719,706
Reconciliation of Operating Loss to Net Cash		
Provided by Operating Activities:		
Net operating loss	\$ (2,630,582)	\$ (1,863,301)
Adjustments to cash used in operating activities:		
Depreciation expense	1,249,661	1,231,474
(Increase) decrease in Accounts receivable	(343,766)	(242,191)
(Increase) decrease in Prepaid water charges	252,755	(187,071)
(Increase) decrease in Prepaid expenses	-	5,836
(Increase) decrease in Accounts receivable water banking	-	659,688
Increase (decrease) in Accounts payable	(159,772)	265,698
Increase (decrease) in Meter set deposits	37,471	(7,358)
Increase (decrease) in Taxes and insurance	1,782	3,909
Net cash provided (used) in operating activities	\$ (1,592,451)	\$ (133,316)

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

WESTERN HILLS WATER DISTRICT
Notes to Financial Statements
June 30, 2018 and 2017

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, 2018 and 2017

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, 2018 and 2017

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, 2018 and 2017

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, 2018 or 2017). 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

The following Governmental Accounting Standards Board Statements have been implemented but do not affect the current financial statements:

- GASB Statement No. 75 – *“Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions”*

This Statement, issued in June of 2015, replaces the requirements of Statements No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, for OPEB. Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, establishes new accounting and financial reporting requirements for OPEB plans.

The consistency, comparability, and transparency of the information reported by employers and governmental non-employer contributing entities about OPEB transactions will be improved by requiring:

WESTERN HILLS WATER DISTRICT
Notes to Financial Statements
June 30, 2018 and 2017

1. Summary of Significant Accounting Policies (continued)

New GASB Pronouncements (continued)

- The use of a discount rate that considers the availability of the OPEB plan's fiduciary net position associated with the OPEB of current active and inactive employees and the investment horizon of those resources, rather than utilizing only the long-term expected rate of return regardless of whether the OPEB plan's fiduciary net position is projected to be sufficient to make projected benefit payments and is expected to be invested using a strategy to achieve that return.
- A single method of attributing the actuarial present value of projected benefit payments to periods of employee service, rather than allowing a choice among six methods with additional variations.
- Immediate recognition in OPEB expense, rather than a choice of recognition periods, of the effects of changes of benefit terms.

This Statement will improve the decision-usefulness of information in employer and governmental non-employer contributing entity financial reports and will enhance its value for assessing accountability and inter-period equity by requiring recognition of the entire OPEB liability and a more comprehensive measure of OPEB expense. Decision-usefulness and accountability also will be enhanced through new note disclosures and required supplementary information, as follows:

- More robust disclosures of assumptions will allow for better informed assessments of the reasonableness of OPEB measurements.
 - Explanations of how and why the OPEB liability changed from year to year will improve transparency.
 - The summary OPEB liability information, including ratios, will offer an indication of the extent to which the total liability is covered by resources held by the OPEB plan, if any.
 - For employers that provide benefits through OPEB plans that are administered through trusts that meet the specified criteria, the contribution schedules will provide measures to evaluate decisions related to contributions.
- GASB Statement No. 85 – “*Omnibus 2017*”

The objective of this Statement is to address practice issues that have been identified during implementation and application of certain GASB Statements. This Statement 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]).

The requirements of this Statement will enhance consistency in the application of accounting and financial reporting requirements. Consistent reporting will improve the usefulness of information for users of state and local government financial statements.

WESTERN HILLS WATER DISTRICT
Notes to Financial Statements
June 30, 2018 and 2017

1. Summary of Significant Accounting Policies (continued)

Future GASB Pronouncements

In May 2017, the Governmental Accounting Standards Board (GASB) issued Statement No. 88, *Certain Disclosures Related to Debt, Including Direct Borrowings and Direct Placements* (GASB No. 88). The objective of GASB No. 88 is to improve the information that is disclosed in notes to government financial statements related to debt, including direct borrowings and direct placements. It also clarifies which liabilities governments should include when disclosing information related to debt. The requirements of GASB No. 88 will improve financial reporting by providing users of financial statements with essential information that currently is not consistently provided. In addition, information about resources to liquidate debt and the risks associated with changes in terms associated with debt will be disclosed. As a result, users will have better information to understand the effects of debt on a government's future resource flows. The requirements of GASB No. 88 are effective for reporting periods beginning after June 15, 2018. The District has implemented this standard in preparing these financial statements.

In June 2018 GASB issued Statement No. 89, *Accounting for Interest Cost Incurred Before the End of a Construction Period* (GASB No. 89). The objectives of this Statement are (1) to enhance the relevance and comparability of information about capital assets and the cost of borrowing for a reporting period and (2) to simplify accounting for interest cost incurred before the end of a construction period.

GASB No. 89 establishes accounting requirements for interest cost incurred before the end of a construction period. Such interest cost includes all interest that previously was accounted for in accordance with the requirements of paragraphs 5-22 of GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which are now superseded. GASB No. 89 requires that interest cost incurred before the end of a construction period be recognized as an expense in the period in which the cost is incurred for financial statements prepared using the economic resources measurement focus. As a result, interest cost incurred before the end of a construction period will not be included in the historical cost of a capital asset reported in a business-type activity or enterprise fund.

GASB No. 89 also reiterates that in financial statements prepared using the current financial resources measurement focus, interest cost incurred before the end of a construction period should be recognized as an expenditure on a basis consistent with governmental fund accounting principles.

The requirements of GASB No. 89 are effective for reporting periods beginning after December 15, 2019. Earlier application is encouraged and the requirements of GASB No. 89 should be applied prospectively. The District has implemented this standard in preparing the financial statements for the year ended June 30, 2018.

WESTERN HILLS WATER DISTRICT
Notes to Financial Statements
June 30, 2018 and 2017

1. Summary of Significant Accounting Policies (continued)

Future GASB Pronouncements (continued)

In August 2018, GASB issued Statement No. 90, *Majority Equity Interests – An Amendment of GASB Statements No. 14 and No. 61* (GASB No. 90). The primary objectives of this Statement are to improve the consistency and comparability of reporting a government’s majority equity interest in a legally separate organization and to improve the relevance of financial statement information for certain component units. It defines a majority equity interest and specifies that a majority equity interest in a legally separate organization should be reported as an investment if a government’s holding of the equity interest meets the definition of an investment. A majority equity interest that meets the definition of an investment should be measured using the equity method, unless it is held by a special-purpose government engaged only in fiduciary activities, a fiduciary fund, or an endowment (including permanent and term endowments) or permanent fund. Those governments and funds should measure the majority equity interest at fair value.

The requirements of the Statement 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. 90.

This space intentionally left blank.

WESTERN HILLS WATER DISTRICT
Notes to Financial Statements
June 30, 2018 and 2017

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, 2018, and exceeded the FDIC insured amount of \$250,000 by \$3,664,999.

Cash and cash equivalents consist of the following:

	<u>June 30, 2018</u>	<u>June 30, 2017</u>
Cash	\$ 880,834	\$ 661,354
Restricted cash	<u>2,720,191</u>	<u>6,058,352</u>
Total cash	<u>\$ 3,601,025</u>	<u>\$ 6,719,706</u>

The June 30, 2018, investments in the US Treasury Money Market Trust of \$4,444,378 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>\$4,444,378</u>	N/A	<u>\$ 4,444,378</u>	\$ -	\$ -	\$ -

Restricted Cash

Cash in the amount \$2,720,191 has been restricted by loan agreements for the payment of loan debt service.

This space intentionally left blank.

WESTERN HILLS WATER DISTRICT
Notes to Financial Statements
June 30, 2018 and 2017

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, 2018:

	Balance <u>June 30, 2017</u>	Reclassifications & Additions	Balance <u>June 30, 2018</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	86,248	1,139	87,387	3 to 5
Pump station & well	3,388,913	-	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	43,127	-	43,127	3 to 40
	<u>46,190,780</u>	<u>1,139</u>	<u>46,191,919</u>	
Accumulated depreciation	16,636,060	1,249,661	17,885,721	
Net book value	<u>\$29,554,720</u>	<u>\$ (1,248,522)</u>	<u>\$28,306,198</u>	
Construction in progress	<u>\$11,603,448</u>	<u>\$ 152,578</u>	<u>\$11,756,026</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, 2018 and 2017

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%.

This space intentionally left blank.

WESTERN HILLS WATER DISTRICT
Notes to Financial Statements
June 30, 2018 and 2017

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:

	<u>Year Ended</u> <u>June 30, 2018</u>	<u>Year Ended</u> <u>June 30, 2017</u>
Balance at beginning of year	\$ 45,235,000	\$ 45,710,000
New issuance- bond refunding	-	-
Bond retirements	(2,080,000)	(475,000)
Principal payments	-	-
Balance at end of year	<u>\$ 43,155,000</u>	<u>\$ 45,235,000</u>
Due in one year	<u>\$ 2,300,000</u>	<u>\$ 2,060,000</u>

Debt Schedules

The following are debt service schedules to maturity:

	<u>2014 Bond</u>		
Fiscal Year Ending June 30,	Interest	Principal	Total
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
2023	1,406,708	2,210,000	3,616,708
Thereafter	<u>6,596,730</u>	<u>25,815,000</u>	<u>32,411,730</u>
	<u>\$ 14,503,278</u>	<u>\$ 36,095,000</u>	<u>\$ 50,598,278</u>

This space intentionally left blank.

WESTERN HILLS WATER DISTRICT
Notes to Financial Statements
June 30, 2018 and 2017

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
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
2023	223,341	455,000	678,341
Thereafter	<u>1,053,946</u>	<u>4,970,000</u>	<u>6,023,946</u>
	<u>\$ 2,330,416</u>	<u>\$ 7,060,000</u>	<u>\$ 9,390,416</u>

<u>All Bonds</u>			
Fiscal Year Ending June 30,	Interest	Principal	Total
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
2023	1,630,049	2,665,000	4,295,049
Thereafter	<u>7,650,676</u>	<u>30,785,000</u>	<u>38,435,676</u>
	<u>\$ 16,833,694</u>	<u>\$ 43,155,000</u>	<u>\$ 59,988,694</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, 2018:

- (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: \$5,393,228

WESTERN HILLS WATER DISTRICT
Notes to Financial Statements
June 30, 2018 and 2017

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, 2018, 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, 2018	<u>\$ 4,444,378</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%.

This space intentionally left blank.

WESTERN HILLS WATER DISTRICT
Notes to Financial Statements
June 30, 2018 and 2017

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
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>\$ 210,876</u>	<u>\$ 1,556,078</u>	<u>\$ 1,766,954</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
2019	\$ 9,043	\$ 22,925	\$ 31,968
2020	6,746	25,248	31,994
2021	4,218	27,775	31,993
2022	1,669	22,469	24,138
2023	90	5,627	5,717
	<u>\$ 21,766</u>	<u>\$ 104,044</u>	<u>\$ 125,810</u>

All Notes

Fiscal Year Ending June 30,	Interest	Principal	Total
2019	\$ 99,577	\$ 383,521	\$ 483,098
2020	73,304	409,820	483,124
2021	44,854	438,269	483,123
2022	14,817	422,885	437,702
2023	90	5,627	5,717
	<u>\$ 232,642</u>	<u>\$ 1,660,122</u>	<u>\$ 1,892,764</u>

WESTERN HILLS WATER DISTRICT
Notes to Financial Statements
June 30, 2018 and 2017

6. Going Concern

The District has incurred operating losses of \$2,630,582 in 2018 and \$1,863,301 in 2017. At June 30, 2018 and 2017, the District's deficit net position was \$(16,368,927) and \$(13,603,812), respectively, which indicates that the District is theoretically insolvent. The net investments in capital assets, which is the value of those assets less the outstanding amount owed on the debt used to acquire them was \$(4,752,898) and \$(6,095,791) at June 30, 2018 and 2017, respectively.

The District's negative net position as described above raises substantial doubt about the District's ability to continue as a going concern within one year after the issuance date of the financial statements. District management is working with the owner of the development to promote the completion of the community, which may result in more home sales. More home sales would also result in more sewer service charges and more property tax revenues, which are necessary to repay the outstanding obligations of the District and cover its operating costs.

The District's assets are substantially in place as of June 30, 2018 and 2017. However, the operations including water revenue will not be fully realized until the development is completed. At June 30, 2018 and 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 (see Note 7 for more detail).

The accompanying financial statements have been prepared assuming that the District will continue as a going concern; however, the above conditions raise substantial doubt about the District's ability to do so. The financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classifications of liabilities that may result should the District be able to continue as a going concern.

7. Related Parties

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, 2018 and 2017, advances payable to World International LLC were \$15,759,995 and \$14,709,995, respectively.

WESTERN HILLS WATER DISTRICT
Notes to Financial Statements
June 30, 2018 and 2017

8. Payables Concentration

Of the total accounts payable balance of \$4,176,242 and \$4,336,014 at June 30, 2018 and 2017, respectively, \$4,000,626 was a delinquent account payable to Veolia Water in both years. As of the date of this report, Veolia Water has not pursued any litigation to collect the delinquent balance due from the District.

9. 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.



2700 Ygnacio Valley Road, Ste 270
Walnut Creek, CA 94598
(925) 932-3860 tel
(925) 476-9930 efax
www.cropperaccountancy.com

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

To the Board of Directors
Western Hills Water District

We have audited, in accordance with the 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, as of and for the year ended June 30, 2018, 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 March 22, 2019.

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.

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. 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.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. We did identify certain deficiencies in internal control, described in the Communication with Those Charged with Governance at the Conclusion of an Audit dated March 22, 2019, that we consider to be material weaknesses.

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 is described in the Communication with Those Charged with Governance at the Conclusion of an Audit. 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

March 22, 2019