

**WESTERN HILLS WATER DISTRICT**  
**FINANCIAL STATEMENTS**  
**JUNE 30, 2012 and 2011**

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**Western Hills Water District**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**For Year Ending June 30, 2012**

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, 2012. Please read it in conjunction with the Basic Financial Statements, which follow this section.

**FINANCIAL HIGHLIGHTS**

- The District's total assets decreased by \$1.3 million, or 2.3%, to \$55.3 million.
- During the year the District's operating revenue increased by 2.9% to \$2.15 million, while operating expenses increased by 1.8% to \$4.0 million.
- Net position decreased by \$996 thousand to \$(9.00) 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, Financial Statements, Capital Assets, Long-Term Debt and Subsequent Event – Bankruptcy of Developer. This report also contains other supplementary information based on these statements.

**BASIC FINANCIAL STATEMENTS**

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

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

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

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

## FINANCIAL ANALYSIS OF THE DISTRICT

One of the most important questions asked about the District's finances is, "Is the District, as a whole better off or worse off as a result of the year's activities?" You can think of the District's net position (the difference between assets and liabilities) as one way to measure financial health or financial position. Over time, increases or decreases in the District's net position are one indicator of whether its financial health is improving or deteriorating. However, until a new entity has stabilized, there may be mitigating factors on why net assets tend 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 assets decreased by \$996 thousand to \$(9.00) million in fiscal year 2012. This is down from \$(8.01) million in fiscal year 2011. This decrease is a result of the following:

1. Assets decreased by \$1.3 million, primarily due to depreciation of fixed assets and funding the current year's debt service on bonds payable.
2. Liabilities decreased by \$310 thousand, due to a \$1.5 million decrease in the bonds payable and long-term debt, net of their current portions, which was offset by a \$1.2 million increase in current liabilities (primarily due to a \$1.1 million increase in accounts payable)

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

|                          | <b>2012</b>       | <b>2011</b>       |
|--------------------------|-------------------|-------------------|
| Current Assets           | \$ 3,156          | \$ 3,304          |
| Restricted Assets        | 6,663             | 6,666             |
| Fixed Assets             | 44,093            | 45,170            |
| Other Assets             | 1,437             | 1,515             |
| <b>Total Assets</b>      | <b>55,349</b>     | <b>56,655</b>     |
| Current Liabilities      | 13,624            | 12,374            |
| Long-Term Debt           | 50,726            | 52,286            |
| <b>Total Liabilities</b> | <b>64,350</b>     | <b>64,660</b>     |
| <b>Net Position</b>      | <b>\$ (9,001)</b> | <b>\$ (8,005)</b> |

### FINANCIAL STATEMENTS

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 2012's challenges at the end of this report.

**TABLE 2**  
**Statement of Revenues & Expenses**  
**For the Years ended June 30, 2012 and 2011**  
**(in thousands)**

|                                               | <u>2012</u>            | <u>2011</u>            | <u>Total %<br/>Change<br/>Fav/(Unfav)</u> |
|-----------------------------------------------|------------------------|------------------------|-------------------------------------------|
| Total Operating Revenues                      | \$ 2,151               | \$ 2,091               | 2.9%                                      |
| Total Operating Expenses (less depreciation)  | <u>2,794</u>           | <u>2,730</u>           | <u>(2.3%)</u>                             |
| <b>Net Operating Loss Before Depreciation</b> | <b><u>\$ (643)</u></b> | <b><u>\$ (639)</u></b> | <b><u>(0.6%)</u></b>                      |

### **CAPITAL ASSETS**

During 2012, the District had \$99 thousand of additional investment in the new water treatment system, and \$18 thousand in additional construction in progress.

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

|                                   | <u>2012</u>             | <u>2011</u>             | <u>Dollar<br/>Change</u> | <u>Total<br/>Percent<br/>Change</u> |
|-----------------------------------|-------------------------|-------------------------|--------------------------|-------------------------------------|
| Water Treatment Facilities/Equipt | \$ 11,438               | \$ 11,339               | \$ 99                    | 0.9%                                |
| Pump Station & Well               | 3,058                   | 3,058                   | -                        | 0.0%                                |
| Aqueduct Turnout                  | 746                     | 746                     | -                        | 0.0%                                |
| Wastewater Treatment Facility     | 28,104                  | 28,104                  | -                        | 0.0%                                |
| Back-up Generators                | 1,193                   | 1,193                   | -                        | 0.0%                                |
| Construction in Progress          | 10,065                  | 10,047                  | 18                       | 0.2%                                |
| Other                             | <u>48</u>               | <u>48</u>               | <u>-</u>                 | <u>0.0%</u>                         |
| <b>Subtotal</b>                   | <b>54,652</b>           | <b>54,535</b>           | <b>117</b>               | <b>0.2%</b>                         |
| Less Accumulated Depreciation     | <u>10,559</u>           | <u>9,365</u>            | <u>1,194</u>             | <u>12.8%</u>                        |
| <b>Net Book Value</b>             | <b><u>\$ 44,093</u></b> | <b><u>\$ 45,170</u></b> | <b><u>\$ (1,077)</u></b> | <b><u>(2.4%)</u></b>                |

### **LONG TERM DEBT**

At year-end, the District had \$52.3 million in long-term debt. This is a net decrease of \$1.4 million from 2011, due to bond and note payments made during the year.

The District has outstanding general obligation debt stemming from Mello-Roos bonds issued in August 2001, December 2002, May 2004 and June 2005. The District's current average cost of capital is 6.0% in outstanding debt, as shown on Table 4. Amortized discount and deferred loss on refunding are not included in the outstanding bond balance shown on Table 4.

**TABLE 4**  
**Outstanding Debt**

|                          | <u>Debt Balance</u> | <u>Average Rate</u> |
|--------------------------|---------------------|---------------------|
| General Obligation Bonds | <u>\$48,995</u>     | <u>6.0%</u>         |
| Caterpillar Note Payable | <u>\$ 3,291</u>     | <u>6.41%</u>        |

## **2012 CHALLENGES AND A LOOK AT THE FUTURE:**

Western Hills Water District's assets are notably in place as of June 30, 2012.

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

As of January 1, 2011, ordinance No. 2010-1 was adopted and new sewer rates took effect. These rates equal the pass through amounts paid to the City of Patterson and will run through June 30, 2015.

On June 23, 2011, ordinance No. 2011-1 was adopted and new water rates will take affect starting August 1, 2011. This ordinance has specific rate increases for the next three years. Starting July 1, 2014, water rates will automatically increase annually for inflation in accordance with Bureau of Labor Statistics Consumer Price Index.

Western Hill's future projects include the WTP SWPPP Implementation and Pump Station 1 Magnetic Meter.

With the District's new income streams losses will become less over the next 10 years. New development is on the horizon and is looking promising for new houses. This is welcome news since the district has not set a meter since 2006. Also, the new water banking program has been embraced and has produced a much needed income stream. This program will work well as long as is keeps raining and there isn't a drought.

## **CONTACTING THE DISTRICT'S FINANCIAL MANAGER**

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

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

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

## INDEPENDENT AUDITORS' REPORT

To the Board of Directors of  
Western Hills Water District  
Patterson, California

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

We have audited the accompanying financial statements of **Western Hills Water District** as of and for the years ended June 30, 2012 and 2011, and the related notes to the financial statements, which collectively comprise **Western Hills Water District's** basic financial statements as listed in the table of contents.

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

**Western Hills Water District's** management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### ***Auditor's Responsibility***

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States as well as the State Controller's Audit Requirements for California Special Districts. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

### *Opinion*

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of **Western Hills Water District** as of June 30, 2012 and 2011, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America as well as accounting systems prescribed for special districts by the Office of the California State Controller.

### *Other Matters*

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

  
CROPPER ACCOUNTANCY CORPORATION

June 2, 2014  
Walnut Creek, California

# WESTERN HILLS WATER DISTRICT

## Statements of Net Position

June 30, 2012 and 2011

|                                                                                                                    | <u>ASSETS</u>        |                      |
|--------------------------------------------------------------------------------------------------------------------|----------------------|----------------------|
|                                                                                                                    | <u>2012</u>          | <u>2011</u>          |
| Current Assets                                                                                                     |                      |                      |
| Cash                                                                                                               | \$ 2,312,083         | \$ 2,555,265         |
| Accounts receivable                                                                                                | 293,669              | 282,282              |
| Prepaid water charges                                                                                              | 544,226              | 459,637              |
| Meter inventory                                                                                                    | <u>6,480</u>         | <u>6,480</u>         |
| Total current assets                                                                                               | <u>3,156,458</u>     | <u>3,303,664</u>     |
| Assets restricted for debt service, at current values                                                              |                      |                      |
| Federated money market trust                                                                                       |                      |                      |
| U.S. Treasury Obligations                                                                                          | <u>6,662,853</u>     | <u>6,666,203</u>     |
| Total restricted assets                                                                                            | <u>6,662,853</u>     | <u>6,666,203</u>     |
| Deferred bond costs, net of accumulated amortization of<br>\$707,959 and \$630,653 for 2012 and 2011, respectively | 1,437,428            | 1,514,733            |
| Fixed Assets, net of accumulated depreciation of \$10,559,400<br>and \$9,364,961 for 2012 and 2011, respectively   | 34,027,301           | 35,122,824           |
| Construction in progress                                                                                           | <u>10,065,189</u>    | <u>10,047,580</u>    |
| Total assets                                                                                                       | <u>\$ 55,349,229</u> | <u>\$ 56,655,004</u> |
| <br><u>LIABILITIES AND NET POSITION</u>                                                                            |                      |                      |
| Current Liabilities                                                                                                |                      |                      |
| Accounts payable                                                                                                   | 10,995,782           | 9,855,347            |
| Accrued interest payable                                                                                           | 1,033,907            | 1,055,500            |
| Customer deposits                                                                                                  | 28,750               | 26,325               |
| Other current liabilities                                                                                          | 6,050                | 155                  |
| Current portion of FSC gov't loan                                                                                  | 244,437              | 182,008              |
| Current portion of bonds payable                                                                                   | <u>1,315,000</u>     | <u>1,255,000</u>     |
| Total current liabilities                                                                                          | <u>13,623,926</u>    | <u>12,374,335</u>    |
| Caterpillar FSC gov't loan, net of current portion                                                                 | 3,046,328            | 3,290,766            |
| Bonds payable, net of current portion                                                                              | <u>47,680,000</u>    | <u>48,995,000</u>    |
| Total liabilities                                                                                                  | <u>64,350,254</u>    | <u>64,660,101</u>    |
| Net Position                                                                                                       |                      |                      |
| Invested in net assets, net of related debt                                                                        | (8,193,275)          | (8,552,370)          |
| Restricted for bond and reserve funds                                                                              | 5,255,187            | 5,393,904            |
| Unrestricted                                                                                                       | <u>(6,062,937)</u>   | <u>(4,846,631)</u>   |
| Total net position                                                                                                 | <u>(9,001,025)</u>   | <u>(8,005,097)</u>   |
| Total liabilities and net position                                                                                 | <u>\$ 55,349,229</u> | <u>\$ 56,655,004</u> |

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

WESTERN HILLS WATER DISTRICT  
Statements of Cash Flows  
For the Years Ended June 30, 2012 and 2011

|                                                                                           | 2012           | 2011           |
|-------------------------------------------------------------------------------------------|----------------|----------------|
| Cash flows from operating activities                                                      |                |                |
| Receipts from customers and users                                                         | \$ 2,141,828   | \$ 1,823,760   |
| Payments to suppliers of goods and services                                               | (1,343,234)    | (1,180,737)    |
| Payments to employees and related benefits                                                | (389,088)      | (186,851)      |
| Net cash provided by operating activities                                                 | 409,506        | 456,172        |
| Cash flows from capital and related financing activities                                  |                |                |
| Bond indebtedness retired                                                                 | (1,255,000)    | (1,195,000)    |
| Payments on Caterpillar loan                                                              | (182,009)      | (193,458)      |
| Fixed asset additions, including construction in progress                                 | (116,525)      | (31,503)       |
| Interest paid on bonded indebtedness                                                      | (3,107,559)    | (3,252,372)    |
| Other interest paid                                                                       | (213,448)      | (226,549)      |
| Bond related expenses                                                                     | 81,159         | 116,961        |
| Property taxes collected for debt                                                         | 4,228,503      | 4,805,283      |
| Recovery of bond costs                                                                    | (91,592)       | (49,513)       |
| Net used in capital and financing activities                                              | (656,471)      | (26,151)       |
| Cash flows from investing activities                                                      |                |                |
| Decrease (increase) in investments                                                        | 3,350          | (296,257)      |
| Investment income received                                                                | 433            | 662            |
| Net cash provided (used) in investing activities                                          | 3,783          | (295,595)      |
| Net increase (decrease) in cash                                                           | (243,182)      | 134,426        |
| Cash at beginning of year                                                                 | 2,555,265      | 2,420,839      |
| Cash at end of year                                                                       | \$ 2,312,083   | \$ 2,555,265   |
| <b>Reconciliation of Operating Loss to Net Cash<br/>Provided By Operating Activities:</b> |                |                |
| Net operating loss                                                                        | \$ (1,837,711) | \$ (1,826,673) |
| Adjustments to cash used in operating activities:                                         |                |                |
| Depreciation expense                                                                      | 1,194,438      | 1,187,544      |
| (Increase) decrease in assets                                                             |                |                |
| Accounts receivable                                                                       | (11,387)       | (282,282)      |
| Prepaid water charges                                                                     | (84,589)       | (190,319)      |
| Increase (decrease) in liabilities                                                        |                |                |
| Accounts payable                                                                          | 1,140,435      | 1,552,579      |
| Meter set deposits                                                                        | 2,425          | 15,325         |
| Taxes and insurance                                                                       | 5,895          | (2)            |
| Net cash provided by operating activities                                                 | \$ 409,506     | \$ 456,172     |
| Supplemental Disclosure of Non-Cash Transactions:                                         |                |                |
| Amortization of deferred bond costs                                                       | \$ 77,305      | \$ 77,306      |

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

WESTERN HILLS WATER DISTRICT  
Notes to Financial Statements  
June 30, 2012 and 2011

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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, as amended, for a total of \$57,000,000 as of June 30, 2012. The bonds are secured by and payable from a pledge of special taxes to be levied on approximately 5,070 acres of real property within the boundaries of the District. The Bond provisions indicate that:

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

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

Fund accounting classification

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

WESTERN HILLS WATER DISTRICT  
Notes to Financial Statements  
June 30, 2012 and 2011

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1. Summary of Significant Accounting Policies (continued)

Basis of accounting

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

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

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

Cash and cash equivalents

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

Investments

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

Meter inventory

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

Fixed assets

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

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

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

Vacation accrual

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

WESTERN HILLS WATER DISTRICT  
Notes to Financial Statements  
June 30, 2012 and 2011

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1. Summary of Significant Accounting Policies (continued)

Net position

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

Operating vs. non-operating revenues

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

Property Taxes

Property tax revenue is recognized in the fiscal year for which the tax is levied. The County of Contra Costa 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, 2012 or 2011). Actual results could differ from these estimates.

Reclassifications

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

New Accounting Pronouncements

In November of 2010, GASB issued GASBS No. 60, Accounting and Financial Reporting for Service Concession Arrangements. The objective of this Statement is to improve financial reporting by addressing issues related to service concession arrangements (SCAs), which are a type of public-private or public-public partnership. As used in this Statement, an SCA is an arrangement between a transferor (a government) and an operator (governmental or nongovernmental entity) in which (1) the transferor conveys to an operator the right and related obligation to provide services through the use of infrastructure or another public asset (a "facility") in exchange for significant consideration and (2) the operator collects and is compensated by fees from third parties. The District is required to implement the provisions of this Statement for the year ended June 30, 2013 (effective for periods beginning after December 15, 2011). The District has no known SCAs that would require disclosure or have a material effect on the financial statements of the District.

# WESTERN HILLS WATER DISTRICT

## Notes to Financial Statements

June 30, 2012 and 2011

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### 1. Summary of Significant Accounting Policies (continued)

#### New Accounting Pronouncements (continued)

In November of 2010, GASB issued GASBS No. 61, *The Financial Reporting Entity: Omnibus*. This Statement amends Statements No. 14 and 34, to modify certain requirements for inclusion of component units in the financial reporting entity. For organizations that previously were required to be included as component units by meeting the fiscal dependency criteria, a financial benefit or burden relationship also would need to be present between the primary government and that organization for it to be included in the reporting entity as a component unit. Further, for organizations that do not meet the financial accountability criteria for inclusion as component units but that, nevertheless, should be included because the primary government's management determines that it would be misleading to exclude them, this Statement clarifies the manner in which that determination should be made and the types of relationships that generally should be considered in making the determination.

This Statement also amends the criteria for reporting component units as if they were part of the primary government (that is, blending) in certain circumstances and clarifies the reporting of equity interests in legally separate organizations. It requires a primary government to report its equity interest in a component unit as an asset. The District is required to implement the provisions of this Statement for the current fiscal year (effective for periods beginning after June 15, 2012). This Statement did not result in a change in current practice, or have a material effect on the financial statements of the District.

In December of 2010, GASB issued GASBS No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. The objective of this Statement is to incorporate into the GASB's authoritative literature certain accounting and financial reporting guidance that is included in the following pronouncements issued on or before November 30, 1989, which does not conflict with or contradict GASB pronouncements:

1. Financial Accounting Standards Board (FASB) Statements and Interpretations
2. Accounting Principles Board Opinions
3. Accounting Research Bulletins of the American Institute of Certified Public Accountants' (AICPA) Committee on Accounting Procedure.

This Statement also supersedes Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, thereby eliminating the election provided in paragraph 7 of that Statement for enterprise funds and business-type activities to apply post-November 30, 1989 FASB Statements and Interpretations that do not conflict with or contradict GASB pronouncements. However, those entities can continue to apply, as other accounting literature, post-November 30, 1989 FASB pronouncements that do not conflict with or contradict GASB pronouncements, including this Statement. The District is required to implement the provisions of this Statement for the current fiscal year (effective for periods beginning after December 15, 2011). This Statement did not result in a change in current practice, or have a material effect on the financial statements of the District.

WESTERN HILLS WATER DISTRICT  
Notes to Financial Statements  
June 30, 2012 and 2011

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1. Summary of Significant Accounting Policies (continued)

New Accounting Pronouncements (continued)

In June of 2011, GASB issued GASBS No. 63, *Financial Reporting and Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. This Statement provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources. Concepts Statement No. 4, *Elements of Financial Statements*, introduced and defined those elements as a consumption of net assets by the government that is applicable to a future reporting period, and an acquisition of net assets by the government that is applicable to a future reporting period, respectively. Previous financial reporting standards do not include guidance for reporting those financial statement elements, which are distinct from assets and liabilities.

Concepts Statement No. 4 also identifies net position as the residual of all other elements presented in a statement of financial position. This Statement amends the net asset reporting requirements in Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, and other pronouncements by incorporating deferred outflows of resources and deferred inflows of resources into the definitions of the required components of the residual measure and by renaming that measure as net position, rather than net assets. The District is required to implement the provisions of this Statement for the current fiscal year (effective for periods beginning after December 15, 2011). This Statement did not result in a change in current practice, or have a material effect on the financial statements of the District.

In March of 2012, GASB issued GASBS No. 65, *Items Previously Reported as Assets and Liabilities*. This Statement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. This Statement also provides other financial reporting guidance related to the impact of the financial statement elements deferred outflows of resources and deferred inflows of resources, such as changes in the determination of the major fund calculations and limiting the use of the term deferred in financial statement presentations. The District is required to implement the provisions of this Statement for the year ended June 30, 2014 (effective for periods beginning after December 31, 2012). This Statement will not result in a change in current practice, or have a material effect on the financial statements of the District.

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

WESTERN HILLS WATER DISTRICT  
Notes to Financial Statements  
June 30, 2012 and 2011

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1. Summary of Significant Accounting Policies (continued)

New Accounting Pronouncements (continued)

The objective of this Statement is to improve accounting and financial reporting for a governmental financial reporting entity by resolving conflicting guidance that resulted from the issuance of two pronouncements, Statements No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, and No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. The District is required to implement the provisions of this Statement for the year ended June 30, 2014 (effective for periods beginning after December 31, 2012). This Statement will not result in a change in current practice, or have a material effect on the financial statements of the District.

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

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

WESTERN HILLS WATER DISTRICT  
Notes to Financial Statements  
June 30, 2012 and 2011

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1. Summary of Significant Accounting Policies (continued)

New Accounting Pronouncements (continued)

The requirements of this Statement will improve financial reporting primarily through enhanced note disclosures and schedules of required supplementary information that will be presented by the pension plans. The new information will enhance the decision-usefulness of the financial reports of these pension plans, their value for assessing accountability, and their transparency by providing information about measures of net pension liabilities and explanations of how and why those liabilities changed from year to year. The net pension liability information will offer an up-to-date indication of the extent to which the total pension liability is covered by the fiduciary net position of the pension plan. The contribution schedule will provide measures to evaluate decisions related to the assessment of contribution rates in comparison to actuarially determined rates. In that circumstance, it also will provide information about whether employers and nonemployer contributing entities are keeping pace with actuarially determined contribution measures. In addition, new information about rates of return on pension plan investments will inform financial report users about the effects of market conditions on the pension plan's assets over time and provide information for users to assess the relative success of the pension plan's investment strategy and the relative contribution that investment earnings provide to the pension plan's ability to pay benefits to plan members when they come due. The District is required to implement the provisions of this Statement for the year ended June 30, 2014 (effective for periods beginning after June 15, 2013). This Statement will result in a change in current practice, and may have a material effect on the financial statements of the District.

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

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

WESTERN HILLS WATER DISTRICT  
Notes to Financial Statements  
June 30, 2012 and 2011

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1. Summary of Significant Accounting Policies (continued)

New Accounting Pronouncements (continued)

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

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

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

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

This Statement requires cost-sharing employers to present in required supplementary information 10-year schedules containing (1) the net pension liability and certain related ratios and (2) information about required contributions, contributions to the pension plan, and related ratios. The District is required to implement provisions of this Statement for the year ended June 30, 2015 (effective for periods beginning after June 15, 2014). This Statement will result in a change in current practice, and may have a material effect on the financial statements of the District.

WESTERN HILLS WATER DISTRICT  
Notes to Financial Statements  
June 30, 2012 and 2011

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1. Summary of Significant Accounting Policies (continued)

New Accounting Pronouncements (continued)

In January of 2013, GASB issued GASBS No. 69, *Government Combinations and Disposals of Government Operations*. This Statement establishes accounting and financial reporting standards related to government combinations and disposals of government operations. As used in this Statement, the term government combinations includes a variety of transactions referred to as mergers, acquisitions, and transfers of operations.

This Statement requires the use of carrying values to measure the assets and liabilities in a government merger; it also requires measurements of assets acquired and liabilities assumed generally to be based upon their acquisition values, provides accounting and financial reporting guidance for disposals of government operations that have been transferred or sold, and requires disclosures to be made about government combinations and disposals of government operations to enable financial statement users to evaluate the nature and financial effects of those transactions. The District is required to implement provisions of this Statement for the year ended June 30, 2015 (effective for periods beginning after December 15, 2013). This Statement will not result in a change in current practice, or have a material effect on the financial statements of the District.

In April of 2013, GASB issued GASBS No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*. The objective of this Statement is to improve accounting and financial reporting by state and local governments that extend and receive nonexchange financial guarantees. This Statement specifies the information required to be disclosed by governments that extend nonexchange financial guarantees. In addition, this Statement requires new information to be disclosed by governments that receive nonexchange financial guarantees. The requirements of this Statement will enhance comparability of financial statements among governments by requiring consistent reporting. The District is required to implement provisions of this Statement for the year ended June 30, 2014 (effective for periods beginning after June 15, 2013). This Statement will not result in a change in current practice, or have a material effect on the financial statements of the District.

2. Cash and Investments

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

The cash balance (before outstanding checks) was held in two institutions at June 30, 2012, and the total balances in one institution did exceed the FDIC insured amount of \$250,000 by \$2,696,402. The June 30, 2012, investments in the US Treasury Money Market Trust of \$6,662,853 were reflected on the balance sheet as assets restricted for debt services.

# WESTERN HILLS WATER DISTRICT

## Notes to Financial Statements

June 30, 2012 and 2011

### 2. Cash and Investments (continued)

#### Credit Risk

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

| Investment Type          | Fair<br>Value | Minimum<br>Legal<br>Rating | Not Required<br>To Be<br>Rated | Rating as of Year End |      |         |
|--------------------------|---------------|----------------------------|--------------------------------|-----------------------|------|---------|
|                          |               |                            |                                | AAA                   | A    | Unrated |
| US Treasury Money Market | \$ 6,662,853  | N/A                        | \$ 6,662,853                   | \$ -                  | \$ - | \$ -    |

### 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, 2012:

|                               | Balance<br>June 30,<br>2011 | Reclassifications<br>& Additions | Balance<br>June 30,<br>2012 | Depreciable<br>Life in<br>Years |
|-------------------------------|-----------------------------|----------------------------------|-----------------------------|---------------------------------|
| Water treatment facilities    | \$ 11,339,489               | \$ 79,963                        | \$ 11,419,452               | 40                              |
| Water treatment equipment     | -                           | 18,953                           | 18,953                      | 3 to 5                          |
| Pump station & well           | 3,057,844                   | -                                | 3,057,844                   | 30                              |
| Aqueduct turnout              | 745,802                     | -                                | 745,802                     | 40                              |
| Wastewater treatment facility | 28,103,909                  | -                                | 28,103,909                  | 40                              |
| Back-up generators            | 1,192,610                   | -                                | 1,192,610                   | 15                              |
| Storm drain outfall line      | 2,446                       | -                                | 2,446                       | 40                              |
| Frog pond                     | 10,803                      | -                                | 10,803                      | 30                              |
| Other                         | 34,882                      | -                                | 34,882                      | 3 to 30                         |
|                               | 44,487,785                  | 98,916                           | 44,586,701                  |                                 |
| Accumulated depreciation      | 9,364,961                   | 1,194,439                        | 10,559,400                  |                                 |
| Net book value                | \$ 35,122,824               | \$ (1,095,523)                   | \$ 34,027,301               |                                 |
| Construction in progress      | \$ 10,047,580               | \$ 17,609                        | \$ 10,065,189               | n/a                             |

WESTERN HILLS WATER DISTRICT  
Notes to Financial Statements  
June 30, 2012 and 2011

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

As mentioned in Note 1, WHWD has total debt of \$57,000,000, the proceeds of which fund facility assets. Interest rates on these bonds ranged from 2.25% to 5.7%.

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

|                              | Year Ended<br><u>June 30, 2012</u> | Year Ended<br><u>June 30, 2011</u> |
|------------------------------|------------------------------------|------------------------------------|
| Balance at beginning of year | \$ 50,250,000                      | \$ 51,445,000                      |
| Bonds issued                 | -                                  | -                                  |
| Principal payments           | (1,255,000)                        | (1,195,000)                        |
| Balance at end of year       | <u>\$ 48,995,000</u>               | <u>\$ 50,250,000</u>               |
| Due in one year              | <u>\$ 1,315,000</u>                | <u>\$ 1,255,000</u>                |

The following is a debt service schedule to maturity:

| <u>2001 Bond</u>               |                      |                      |                      |
|--------------------------------|----------------------|----------------------|----------------------|
| Fiscal Year<br>Ending June 30, | Interest             | Principal            | Total                |
| 2013                           | \$ 1,238,686         | \$ 460,000           | \$ 1,698,686         |
| 2014                           | 1,206,861            | 490,000              | 1,696,861            |
| 2015                           | 1,172,859            | 525,000              | 1,697,859            |
| 2016                           | 1,136,511            | 560,000              | 1,696,511            |
| 2017                           | 1,097,819            | 595,000              | 1,692,819            |
| Thereafter                     | <u>9,427,743</u>     | <u>15,750,000</u>    | <u>25,177,743</u>    |
|                                | <u>\$ 15,280,479</u> | <u>\$ 18,380,000</u> | <u>\$ 33,660,479</u> |

| <u>2002 Bond</u>               |                     |                     |                     |
|--------------------------------|---------------------|---------------------|---------------------|
| Fiscal Year<br>Ending June 30, | Interest            | Principal           | Total               |
| 2013                           | \$ 336,365          | \$ 190,000          | \$ 526,365          |
| 2014                           | 324,675             | 200,000             | 524,675             |
| 2015                           | 310,669             | 215,000             | 525,669             |
| 2016                           | 295,819             | 225,000             | 520,819             |
| 2017                           | 280,125             | 240,000             | 520,125             |
| Thereafter                     | <u>1,671,299</u>    | <u>4,030,000</u>    | <u>5,701,299</u>    |
|                                | <u>\$ 3,218,952</u> | <u>\$ 5,100,000</u> | <u>\$ 8,318,952</u> |

# WESTERN HILLS WATER DISTRICT

## Notes to Financial Statements

June 30, 2012 and 2011

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

#### 2004 Bond

| Fiscal Year<br>Ending June 30, | Interest             | Principal            | Total                |
|--------------------------------|----------------------|----------------------|----------------------|
| 2013                           | \$ 1,026,450         | \$ 425,000           | \$ 1,451,450         |
| 2014                           | 1,004,575            | 450,000              | 1,454,575            |
| 2015                           | 981,575              | 470,000              | 1,451,575            |
| 2016                           | 957,141              | 495,000              | 1,452,141            |
| 2017                           | 930,675              | 525,000              | 1,455,675            |
| Thereafter                     | <u>8,541,016</u>     | <u>15,080,000</u>    | <u>23,621,016</u>    |
|                                | <u>\$ 13,441,432</u> | <u>\$ 17,445,000</u> | <u>\$ 30,886,432</u> |

#### 2005 Bond

| Fiscal Year<br>Ending June 30, | Interest            | Principal           | Total                |
|--------------------------------|---------------------|---------------------|----------------------|
| 2013                           | \$ 437,658          | \$ 240,000          | \$ 677,658           |
| 2014                           | 426,750             | 250,000             | 676,750              |
| 2015                           | 415,013             | 260,000             | 675,013              |
| 2016                           | 402,441             | 275,000             | 677,441              |
| 2017                           | 388,963             | 285,000             | 673,963              |
| Thereafter                     | <u>3,309,423</u>    | <u>6,760,000</u>    | <u>10,069,423</u>    |
|                                | <u>\$ 5,380,248</u> | <u>\$ 8,070,000</u> | <u>\$ 13,450,248</u> |

#### All Bonds

| Fiscal Year<br>Ending June 30, | Interest             | Principal            | Total                |
|--------------------------------|----------------------|----------------------|----------------------|
| 2013                           | \$ 3,039,159         | \$ 1,315,000         | \$ 4,354,159         |
| 2014                           | 2,962,861            | 1,390,000            | 4,352,861            |
| 2015                           | 2,880,116            | 1,470,000            | 4,350,116            |
| 2016                           | 2,791,912            | 1,555,000            | 4,346,912            |
| 2017                           | 2,697,582            | 1,645,000            | 4,342,582            |
| Thereafter                     | <u>22,949,481</u>    | <u>41,620,000</u>    | <u>64,569,481</u>    |
|                                | <u>\$ 37,321,111</u> | <u>\$ 48,995,000</u> | <u>\$ 86,316,111</u> |

WESTERN HILLS WATER DISTRICT  
Notes to Financial Statements  
June 30, 2012 and 2011

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

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, 2012:

- (a) 10% of the original principal: \$5,700,000
- (b) 100% of the maximum annual debt service on the bonds based on years ended September 1: \$4,354,159
- (c) 125% of the average annual debt service: \$5,394,757

The purpose of this \$4,354,159 reserve is to be used for debt service, if needed. Amounts in excess of the requirement, due to interest thereon, can be transferred to the Bond Fund to be used for current debt service. When the Reserve Fund exceeds the requirement to redeem the remaining outstanding bonds such excess shall be transferred to the District to be used for any lawful purpose.

Bond fund

The Bond Fund consists of amounts held in trust by the Fiscal Agent for payments to bond holders (debt service). Annual special taxes assessed and collected shall be set aside for the debt service. During the fiscal years through June 30, 2012, property taxes were received on assessed property totaling \$36,231,575 from inception. Debt service payments totaled \$37,632,940 in interest and principal. \$2,302,393 has been applied out of special tax fund proceeds set aside for early short-term interest payments, leaving \$35,330,547 to be paid out of the "Bond Fund." Thus, \$901,028 of the taxes assessed remains in the Bond Fund set aside.

Special Tax Fund

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

Improvement Fund

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

WESTERN HILLS WATER DISTRICT  
Notes to Financial Statements  
June 30, 2012 and 2011

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

At June 30, 2012, the reserve requirements were as follows:

|                                                   |                     |
|---------------------------------------------------|---------------------|
| Reserve Fund                                      | \$ 4,354,159        |
| Bond Fund                                         | 901,028             |
| Total reserve requirement                         | <u>\$ 5,255,187</u> |
| Funds set aside for debt service at June 30, 2012 | <u>\$ 6,747,868</u> |

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

5. Caterpillar Note Payable

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

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

| Fiscal Year<br>Ending June 30, | Interest            | Principal           | Total               |
|--------------------------------|---------------------|---------------------|---------------------|
| 2013                           | 206,693             | 244,437             | 451,130             |
| 2014                           | 190,325             | 260,805             | 451,130             |
| 2015                           | 172,861             | 278,269             | 451,130             |
| 2016                           | 154,646             | 296,484             | 451,130             |
| 2017                           | 134,375             | 316,755             | 451,130             |
| Thereafter                     | <u>324,040</u>      | <u>1,894,015</u>    | <u>2,218,055</u>    |
|                                | <u>\$ 1,182,940</u> | <u>\$ 3,290,765</u> | <u>\$ 4,473,705</u> |

6. Retained Earnings (Deficit) and Capital

The District's assets are substantially in place as of June 30, 2012. However, the operations including water revenue will not be fully realized until the development is completed. At June 30, 2012, the primary customers were the 2 golf courses, clubhouse/restaurant, vineyard and the first phase of residential development homeowners. The development plan includes a hotel, single family homes, condos and public facilities. Until it comes to fruition, the water revenue will not cover expenses. It is anticipated, but not guaranteed, that the deficit will be funded by the developer.

WESTERN HILLS WATER DISTRICT  
Notes to Financial Statements  
June 30, 2012 and 2011

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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, 2012 and 2011, the entire balance due from Diablo Grande LP had been written off due to its bankruptcy. See Note 8.

World International LLC – the successor Developer, which acquired the property contained in the District through the bankruptcy proceedings of Diablo Grande LP. As of June 30, 2012 and 2011, the balance due to the successor Developer was \$6,784,228 and \$5,638,228, respectively.

8. Bankruptcy of Developer

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

9. Payables Concentration

Of the total accounts payable balance of \$10,995,782 at June 30, 2012, \$6,784,228 was payable to World International LLC and \$4,000,626 was a delinquent account payable to Veolia Water. Of the total accounts payable balance of \$9,855,347 at June 30, 2011, \$4,248,663 was payable to World International LLC and \$4,000,626 was a delinquent account payable to Veolia Water. As of April 14, 2014, Veolia Water has not pursued any litigation to collect the delinquent balance due from the District.

10. Going Concern

Continued operating losses coupled with the bankruptcy of the Developer raise doubts about the District's ability to continue as a going concern. The District's management is working with the new 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.

WESTERN HILLS WATER DISTRICT  
Notes to Financial Statements  
June 30, 2012 and 2011

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11. Subsequent Events

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