

**INDEPENDENT AUDITOR'S REPORT**  
**FOR**  
**HMC MANAGEMENT - 2009**

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## INDEPENDENT AUDITOR'S REPORT

Board of Directors  
HMC Management  
P.O. Box 119  
Lakebay, WA 98349

Dear President and Members of the Board:

We have audited the accompanying Balance Sheet of HMC Management (a Washington State Homeowners Association) as of September 30, 2009 and 2008, and the related Statements of Revenues and Expenses (including the Functional Expense Schedule) and Cash Flows, and Changes in Members' Equity for the year then ended. These financial statements are the responsibility of HMC management. 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of HMC Management as of September 30, 2009 and 2008, and the results of operations for the year then ended in conformity with accounting principles generally accepted in the United States of America.

HMC Management has not estimated the remaining lives and replacement costs of the common property and, therefore, has not presented this information that accounting principles generally accepted in the United States of America has determined is required to supplement, although not required to be a part of, the basic financial statements. (See Note C)

Michael J. Kander, CPA  
University Place, WA  
February 12, 2010

**HMC MANAGEMENT**  
**Balance Sheet**  
As of September 30, 2009 and 2008

<b>ASSETS</b>	<b>2009</b>	<b>2008</b>
<b>Current Assets</b>		
Cash and Cash Equivalents (See Note A)		
Cash	\$97,900	103,585
Certificate of Deposit	1,006	1,180
Total Cash and Cash Equivalents	98,906	104,765
Accounts Receivable from Active Members	625	7,871
<b>Total Current Assets</b>	<b>99,531</b>	<b>112,636</b>
<b>Long Term and Other Assets</b>		
Investment in Vanguard Funds (see Note B)	361,739	303,637
Land Aquired (See Note D)	30,000	0
Delinquent Members Receivables, net (see Note D)	20,735	35,194
Note Receivable (See Note E)	11,683	17,590
<b>Total Long Term Assets</b>	<b>424,157</b>	<b>356,421</b>
<b>Plant, Property and Equipment</b>		
Land - Common Use (See Note A)	27,300	27,300
<b>Fixed Assets</b>		
Ferry/Docks	2,108,732	2,108,732
Water System	108,217	108,217
Small Boat Dock (Parks)	65,003	65,003
Roads	31,895	31,895
Office/Equipment	35,313	33,635
less Accumulated Depreciation	(1,338,509)	(1,252,087)
<b>Total Net Fixed Assets, net</b>	<b>1,010,651</b>	<b>1,095,395</b>
<b>Total Plant, Property, and Equipment</b>	<b>1,037,951</b>	<b>1,122,695</b>
<b>TOTAL ASSETS</b>	<b>1,561,639</b>	<b>1,591,752</b>
<b>LIABILITIES AND MEMBERS' EQUITY</b>		
<b>LIABILITIES</b>		
<b>Short Term Liabilities</b>		
Accounts Payable - Trade	10,227	12,546
Prepaid Assessments	15,869	6,000
Security Deposits	8,207	8,257
<b>Total Short Term Liabilities</b>	<b>34,303</b>	<b>26,803</b>
<b>Long Term Liability</b>		
Deferred Gain (See Note E)	11,699	15,002
<b>Total Long Term Liability</b>	<b>11,699</b>	<b>15,002</b>
<b>TOTAL LIABILITIES</b>	<b>46,002</b>	<b>\$41,805</b>

**HMC MANAGEMENT**  
**Balance Sheet**  
As of September 30, 2009 and 2008

Continued	<u>2009</u>	<u>2008</u>
<b>MEMBERS' EQUITY</b>		
Unrestricted Balance	\$1,141,898	1,206,309
Board Designated (See Note B)		
Major Maintenance (Re-engine-10)	12,000	
Major Maintenance (Dry Dock-09)		40,000
Members' Savings Reserves	361,739	303,637
Total Board Designated	<u>373,739</u>	<u>343,637</u>
<b>TOTAL MEMBERS' EQUITY</b>	<u>1,515,637</u>	<u>1,549,946</u>
<b>TOTAL LIABILITIES AND MEMBERS' EQUITY</b>	<u>1,561,639</u>	<u>\$1,591,752</u>

**HMC MANAGEMENT**  
**Statement of Revenues and Expenses**  
**For the Years Ended September 30, 2009 and 2008**

	<u>2009</u>	<u>2008</u>
<b>REVENUES AND OTHER SUPPORT</b>		
General Assessments (See Note A)	\$597,000	470,400
Ferry Fees	165,314	139,029
Delinquent Accounts (Current Year)	14,519	36,051
Miscellaneous	5,815	5,243
HMC Interest & Handling Charges	11,678	8,563
<b>TOTAL REVENUES AND OTHER SUPPORT</b>	<u>794,326</u>	<u>659,286</u>
<b>EXPENSES BY DEPARTMENT (See Schedule 1)</b>		
Ferry	516,584	453,564
Ferry Docks	45,589	42,302
Administration	174,224	163,614
Water	41,797	27,768
Parks	12,660	16,367
Roads	35,838	29,305
<b>TOTAL EXPENSES</b>	<u>826,692</u>	<u>732,920</u>
<b>REVENUES EXCEEDING EXPENSES (LOSS)</b>	<u>(32,366)</u>	<u>(73,634)</u>
<b>OTHER INCOME</b>		
Interest Earned	5,499	15,220
Gain on Installment Sale (See Note E)	3,303	554
<b>TOTAL OTHER INCOME</b>	<u>8,802</u>	<u>15,774</u>
<b>UNUSUAL LOSS</b>		
Exchange of land for delinquent accounts	<u>(10,746)</u>	<u>0</u>
<b>REVENUES EXCEEDING EXPENSES (LOSS)</b>	<u>(34,310)</u>	<u>(\$57,859)</u>

**HMC MANAGEMENT**  
**Statement of Functional Expenses - Schedule 1**  
**October 2008 - September 2009 with Comparative Totals for Prior Period (2008)**

<b>2009 EXPENSE</b>	<b>Ferry</b>	<b>Ferry Docks</b>	<b>--Department-- Administration</b>	<b>Water</b>	<b>Parks</b>	<b>Roads</b>	<b>2009 Total</b>	<b>2008 Total</b>
Payroll (Wages, taxes, and benefits)	\$274,544		88,658	8,209	1,915	0	373,326	354,373
Major Repairs and Maintenance	96,487				1,224	24,593	122,304	42,871
Repairs and Maintenance	4,205	1,516	173	11,323	2,624	4,781	24,623	25,468
Insurance	42,032		25,467				67,499	63,534
Ferry Fuel	48,082						48,082	68,849
Professional Services			34,421	1,829			36,250	35,328
Miscellaneous Service & Supplies	9,396	2,113	10,218	9,594	2,874	4,868	39,063	28,045
Taxes and DNR Lease	3,578	343	5,551	2,981			12,453	7,732
Postage, Printing, Copying			6,267				6,267	7,777
Utilities	488	1,982	2,890	3,533	1,510	0	10,404	7,268
Bad Debt Expense			0				0	6,000
<b>Total Expenses by Department before Depreciation</b>	<b>478,811</b>	<b>5,955</b>	<b>173,645</b>	<b>37,468</b>	<b>10,148</b>	<b>34,243</b>	<b>740,270</b>	<b>647,245</b>
<b>Depreciation</b>	<b>37,773</b>	<b>39,634</b>	<b>579</b>	<b>4,329</b>	<b>2,512</b>	<b>1595</b>	<b>86,422</b>	<b>85,675</b>
<b>Total Expenses by Department after Depreciation</b>	<b>516,584</b>	<b>45,589</b>	<b>174,224</b>	<b>41,797</b>	<b>12,660</b>	<b>35,838</b>	<b>826,692</b>	<b>\$732,920</b>

**HMC MANAGEMENT**  
**Statement of Changes in Members' Equity**  
As of September 30, 2009 and 2008

			<u>Total Members' Equity</u>	
	<u>Members'</u> <u>Savings</u> <u>Reserves</u>	<u>Unrestricted</u> <u>Net Assets</u>	<u>2009</u>	<u>2008</u>
<b>MEMBERS' EQUITY</b>				
<b>BEGINNING OF YEAR</b>	<b>\$303,637</b>	<b>1,246,309</b>	<b>1,549,946</b>	<b>1,607,806</b>
 Excess of Revenues over Expenses (Loss) before Other Income and Other Items		 (32,366)	 (32,366)	 (73,634)
 Transfers from Operating Account to Savings Reserves	 52,603	 (52,603)	 0	 0
 Allocation of Other Income				
- Interest Earned	5,499	0	5,499	15,220
- Unusual Loss		(10,745)	(10,745)	
- Gain on Installment Sale		3,303	3,303	554
 <b>MEMBERS' EQUITY</b>	 <b>361,739</b>	 <b>1,153,898</b>	 <b>1,515,637</b>	 <b>\$1,549,946</b>
<b>END OF YEAR</b>				

**HMC Management**  
**Statement of Cash Flows**  
For the Years Ended September 2009 and 2008

	<u>2009</u>	<u>2008</u>
<b>OPERATING ACTIVITIES</b>		
Net Income (Loss)	(\$32,366)	(57,859)
Adjustments to reconcile Net Income to net cash provided by operations: Increase(Decrease)		
Transfer to Investment Account (Reserves)	(58,102)	(3,000)
Interest Earned (General Account)	0	(11,018)
Loss on Acquiring Land (SEE NOTE D)	10,746	0
Depreciation	86,422	85,675
Delinquent Accounts Receivable, net (SEE NOTE D)	14,459	10,128
Note Receivable	574	845
Accounts Receivable	7246	(7,206)
Miscellaneous	689	
Accounts Payable	(2,319)	(23,868)
Prepaid Assessments	9,869	905
Security Deposits, net	(50)	1,759
Net cash provided by Operating Activities	<u>29,922</u>	<u>(3,639)</u>
<b>INVESTING ACTIVITIES</b>		
Deferred Gain	(3,303)	(554)
Land Acquired	(30,000)	0
Capital Additions/Improvements	<u>(1,100)</u>	<u>(30,827)</u>
Net cash provided by Investing Activities	<u>(34,403)</u>	<u>(31,381)</u>
Net cash increase(decrease) for period	<u>(4,481)</u>	<u>(35,020)</u>
Cash at beginning of period	<u>104,765</u>	<u>139,785</u>
Cash at end of period	<u><u>98,906</u></u>	<u><u>\$104,765</u></u>



**HMC MANAGEMENT**  
**Notes to Financial Statements**  
For the Fiscal Year Ended September 30, 2009

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**NOTE A: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Organization and Nature of Activities**

HMC Management was incorporated on May 1, 1958, in the State of Washington, as an homeowners' association. HMC Management operates and maintains the common property (including roads, parks, and water service) on Herron Island and the associated private ferry service and wharfs. HMC Management levies annual and special assessments on 405 "assessable" units. (Assessable units are adjacent, contiguous units that are owned by one member.)

**Basis of Accounting**

The financial statements have been prepared in accordance with generally accepted accounting principles and accordingly reflect all significant receivables, payables and other liabilities.

Disbursements from the operating account are generally at the discretion of the board. Disbursements from the reserve savings accounts may be generally made only for specific purposes designated by the board. (See Note B)

**Cash and Cash Equivalents**

HMC Management considers all highly liquid investments available for current use with an initial maturity of three months or less to be cash equivalents. The certificate of deposit is included in this asset category because it may be readily redeemed with an immaterial early withdrawal penalty.

**Investments**

The Vanguard Money Market Funds (Reserves) are considered as long-term assets because management intends to hold these for more than one year. The balance exceeds the Federal Depository Insurance Corporation coverage by approximately \$110,000. Management accepts this risk because Vanguard has not defaulted on any accounts.

**Fixed Assets**

The Company capitalizes property and equipment over \$1,000 and depreciates fixed assets and improvements over their useful life using straight-line depreciation methodology. At acquisition, the estimated useful life of the ferry and ferry docks were 20 years and 40 years respectively. The estimated useful life of capitalized equipment is five to seven years.

**HMC MANAGEMENT**  
**Notes to Financial Statements**  
For the Fiscal Year Ended September 30, 2009

**Land**

HMC Management owns 16 lots that are for common use by the organization and by members. Original acquisition costs were not available. The organization used lowest assessed values for 2001 through 2005 to fairly value the property.

Additionally, HMC Management owns four tracts of land and beach front property for common use, but valuations are unknown.

**Member Assessments**

HMC Management's members are subject to annual assessments (\$1500 per assessable unit in 2009) to provide funds for general operating expenses, future capital acquisitions, and major repairs and replacements. Assessments and accounts receivable at the balance sheet date represent fees due from active owners, excluding assessments on delinquent accounts. HMC Management considers these receivables (active members) as fully collectable and, accordingly, does not deem it necessary to establish an allowance for uncollectable accounts (active members). HMC Policy is to classify assessments older than 30 days as delinquent and to begin legal proceedings as soon as practical. See Note D for discussion of delinquent accounts.

**Income Taxes**

Homeowners' associations may be taxed either as homeowners' associations or as regular corporations. As a homeowner's association, most exempt function income, which consists primarily of member assessments, is not taxable.

**Estimates**

The preparation of financial statements in conformity with generally accepted accounting principles requires HMC Management to make estimates and assumptions that may affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates.

**Insurance**

Management has elected to expense insurance costs when paid. This procedure does not significantly change the financial position or operating results.

**NOTE B – Board Designated Savings Reserves**

These reserves are board designated and consist of investments to be held for the purpose of capital projects, major repairs and improvements (docks, ferry, roads, water), and legal and insurance reserves. These assets are held in a Vanguard Money Market account specified for those purposes. (See Note A)

**HMC MANAGEMENT**  
**Notes to Financial Statements**  
For the Fiscal Year Ended September 30, 2009

**NOTE C – Future Major Repairs and Replacements**

HMC Management's governing documents do not require the accumulation of funds to finance estimated future major repairs and replacements. However, the budget includes a portion for reserves. HMC Management has not completed a study to determine the remaining useful lives of the components of common property and future associated costs of major repairs and replacement.

To fund future projects, HMC Management maintains reserves designated by the board for specific purposes. (See Note B) Whether these funds are sufficient to finance future major repairs and replacements, either directly or through borrowing, has not been determined.

The Board has determined that the water distribution system may need replacing in order to comply with recent Washington State laws. Other near-term capital projects include replacement of the dolphins with an estimated cost of \$81,000, the re-engine of the ferry for \$80,000, and a reserve for parks improvements of \$6,600.

**NOTE D – Delinquent Accounts**

The position of the Board of Directors is that the Association will ultimately prevail against the remaining homeowners whose assessments and accounts are delinquent (without lien filings). Accordingly, no provision for doubtful accounts was made in 2009. However, in 2008 the delinquent accounts receivable, because of lien filings, was reported at a net value and included \$6,000 for uncollectable accounts in 2008.

Two accounts with lien judgments were resolved as uncollectable in 2009, and as a result, the associated property (unimproved) on Herron Island was remanded to HMC at a sheriff's sale.

**NOTE E – Note Receivable**

The seven percent note is for the sale of Herron Island property on July 26, 2005. Terms are monthly payments of \$175 with a balloon payment of \$10,839 due on July 29, 2010.