

MICHAEL KANDER CPA

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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 Statement of Financial Position of HMC Management (a Washington State Homeowners Association) as of September 30, 2006, and the related Activity Statement (revenues and expenses) and Changes in Members' Equity (net assets) 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.

HMC Management did not present a statement of cash flows for the year ended September 30, 2006. Presentation of such statement summarizing the organization's operating, investing, and financing activities is required by generally accepted accounting principles.

In our opinion, except that the omission of a statement of cash flows resulted in an incomplete presentation as explained in the preceding paragraph, the financial statements referred to above present fairly, in all material respects, the financial position of HMC Management as of September 30, 2006, 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
March 1, 2007

HMC MANAGEMENT
STATEMENT OF FINANCIAL POSITION
SEPT 30, 2006 (FY2006)

ASSETS	FY 2006
Current Assets	
Cash and Cash Equivalents (See Note A)	
Cash	\$96,971
Certificate of Deposit	1,072
Total Cash and Cash Equivalents	<u>98,042</u>
Accounts Receivable from Active Members	<u>665</u>
Total Current Assets	<u>98,707</u>
Long Term Assets	
Investment in Vanguard Funds (see Note B)	220,244
Delinquent Members Receivables, net (see Note D)	109,000
Note Receivable (See Note E)	<u>19,213</u>
Total Long Term Assets	<u>348,457</u>
Plant, Property and Equipment	
Land - Common Use (See Note A)	27,300
Fixed Assets	
Ferry/Docks	2,068,020
Water System	108,217
Small Boat Dock (Parks)	65,003
Roads	40,245
Office/Equipment	34,213
less Accumulated Depreciation	<u>(1,121,928)</u>
Total Net Fixed Assets	<u>1,193,771</u>
Total Plant, Property, and Equipment	<u>1,221,071</u>
TOTAL ASSETS	<u><u>1,668,235</u></u>
LIABILITIES AND MEMBERS' EQUITY	
LIABILITIES	
Short Term Liabilities	
Accounts Payable - Trade	7,835
Prepaid Assessments	4,812
Security Deposits	<u>4,322</u>

See Independent Auditor's Report
The Accompanying Notes are an integral part of these financial statements

HMC MANAGEMENT
STATEMENT OF FUNCTIONAL EXPENSES
 Oct 2005 - Sept 2006

FY 2006 EXPENSE	Ferry	Ferry Docks	Administration	Department Water	Parks	Roads
Payroll (Wages, taxes, and benefits)	\$200,144		64,338	5,532	1,091	648
Major Repairs and Maintenance	34,724	24,750				
Repairs and Maintenance	16,583	5,298		11,637	3,218	19,701
Insurance	41,597		21,721			
Ferry Fuel	45,607					
Professional Services			30,521			
Misc Service & Supplies	6,191	780	6,833	8,883	5,757	157
Taxes and DNR Lease	3,424	1,156	3,627	1,565		
Postage, Printing, Copying			8,108			
Utilities		1,170		3,058		
Provision for Uncollectable Assessments - Current Year			6000			
Total Expenses by Department before Depreciation	348,270	33,154	141,148	30,675	10,066	20,506
Depreciation	37,773	35,199	4,051	4,329	785	
Total Expenses by Department after Depreciation	386,043	68,353	145,199	35,004	10,851	20,506

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HMC MANAGEMENT
ACTIVITY STATEMENT AND CHANGES IN MEMBERS' EQUITY
OCT 2005 - SEPT 2006 (FY2006)

ACTIVITY STATEMENT

	<u><u>FY 2006</u></u>
CHANGE IN MEMBERS' EQUITY (NET ASSETS)	
REVENUES AND OTHER SUPPORT	
General Assessments, net	\$419,416
Ferry Fees	147,796
Small Boat Dock Assessment	38,733
Donation for Bulkhead Repair	20,000
Miscellaneous	3,798
HMC Interest & Handling Charges	3,369
TOTAL REVENUES AND OTHER SUPPORT	<u>633,113</u>
EXPENSES BY DEPARTMENT (See Schedule 1)	
Ferry	386,043
Ferry Docks	68,353
Administration	145,199
Water	35,004
Roads	20,506
Parks	10,851
TOTAL EXPENSES	<u>665,956</u>
CHANGE IN MEMBERS' EQUITY BEFORE OTHER ITEMS	<u><u>(32,843)</u></u>
OTHER INCOME	
Collections from Delinquent Accounts (See Note D)	21,319
Interest Earned (all accounts)	18,229
Contract Principal Received	729
TOTAL OTHER INCOME	<u>40,277</u>

STATEMENT OF CHANGES IN MEMBERS' EQUITY

CHANGE (INCREASE) IN MEMBERS' EQUITY (NET ASSETS)	7,434
AFTER OTHER ITEMS	
BEGINNING MEMBERS' EQUITY (NET ASSETS)	<u>1,624,619</u>
ENDING MEMBERS' EQUITY (NET ASSETS)	<u><u>\$1,632,053</u></u>

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HMC MANAGEMENT
Notes to Financial Statements
For the Fiscal Year Ended September 30, 2006

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 a non-profit corporation. 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 approximately 360 members.

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.

The Organization reports information regarding its financial position according to three classes of assets: unrestricted, temporarily restricted, and permanently restricted, as recommended by the AICPA Statement of Financial Accounting Standards No. 117.

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 readily redeemed with an early withdrawal penalty. The Vanguard Money Market Funds (Reserves) are considered as long-term assets because management intends to hold these for more than one year.

Fixed Assets

The HMC Company capitalizes property and equipment over \$500 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.

Land

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

Member Assessments

HMC Management's members are subject to annual assessments to provide funds for general operating expenses, future capital acquisitions, and major repairs and replacements. Accounts receivable at the balance sheet date represents fees due from active owners. HMC Policy is to classify assessments older than 30 days as delinquent and to begin legal proceedings as soon as practical.

HMC MANAGEMENT
Notes to Financial Statements
For the Fiscal Year Ended September 30, 2006

Income Taxes

Homeowners' associations may be taxed either as homeowners' associations or as regular corporations. In either case, 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.

NOTE B – Temporarily Restricted Net Assets

The temporarily restricted net assets 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 Vanguard Money Market accounts specified for those purposes. (See Note A)

During FY 2006, HMC Management transferred \$45,558 from the water reserve account to the general account to reimburse payments made in FY 2005 for the water tank project.

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. 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.

NOTE D – Delinquent Accounts and Related Subsequent Events

The assessments receivable from delinquent members includes approximately \$20,000 as an estimation of the collectable portion of delinquent accounts, in addition to that received after year end.

In February 2007 HMC Management received \$89,000 from delinquent owners, as a result of litigation, which will be appropriately reflected in the FY 2007 financial statements.

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 \$15,839 due on July 29, 2010.