

MICHAEL KANDER CPA

7406 27TH Street West Suite 14, University Place, WA 98466

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, 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, 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
May 16, 2009

HMC MANAGEMENT
Balance Sheet
As of September 30, 2008 and 2007

ASSETS	2008	2007
Current Assets		
Cash and Cash Equivalents (See Note A)		
Cash	\$103,585	\$138,653
Certificate of Deposit	1,180	1,132
Total Cash and Cash Equivalents	104,765	139,785
Accounts Receivable from Active Members	7,871	587
Total Current Assets	112,636	140,373
Long Term and Other Assets		
Investment in Vanguard Funds (see Note B)	303,637	290,873
Delinquent Members Receivables, net (see Note D)	35,194	45,322
Note Receivable (See Note E)	17,590	18,435
Total Long Term Assets	356,421	354,630
Plant, Property and Equipment		
Land - Common Use (See Note A)	27,300	27,300
Fixed Assets		
Ferry/Docks	2,108,732	2,104,931
Water System	108,217	108,217
Small Boat Dock (Parks)	65,003	65,003
Roads	31,895	40,245
Office/Equipment	33,635	34,213
less Accumulated Depreciation	(1,252,087)	(1,203,543)
Total Net Fixed Assets	1,095,395	1,149,067
Total Plant, Property, and Equipment	1,122,695	1,176,367
TOTAL ASSETS	1,591,752	1,671,369
LIABILITIES AND MEMBERS' EQUITY		
LIABILITIES		
Short Term Liabilities		
Accounts Payable - Trade	12,546	36,414
Prepaid Assessments	6,000	5,095
Security Deposits	8,257	6,498
Total Short Term Liabilities	26,803	48,007
Long Term Liability		
Deferred Gain (See Note E)	15,002	15,556
Total Long Term Liability	15,002	15,556
TOTAL LIABILITIES	\$41,805	\$63,563

HMC MANAGEMENT
Balance Sheet
As of September 30, 2008 and 2007

Continued	<u>2008</u>	<u>2007</u>
MEMBERS' EQUITY		
Unrestricted Balance	\$1,206,309	\$1,316,932
Board Designated (See Note B)		
Major Maintenance (Dry Dock) 2009	40,000	
Members' Savings Reserves	<u>303,637</u>	<u>290,873</u>
Total Board Designated	<u>343,637</u>	<u>290,873</u>
TOTAL MEMBERS' EQUITY	<u>1,549,946</u>	<u>1,607,806</u>
TOTAL LIABILITIES AND MEMBERS' EQUITY	<u>\$1,591,752</u>	<u>\$1,671,369</u>

HMC MANAGEMENT
Statement of Revenues and Expenses
For the Years Ended September 30, 2008 and 2007

	<u>2008</u>	<u>2007</u>
REVENUES AND OTHER SUPPORT		
General Assessments, net	\$470,400	\$456,328
Ferry Fees	139,029	152,057
Delinquent Accounts (Current Year)	36,051	31,112
Miscellaneous	5,243	13,043
Donation for Improvements	0	5,639
HMC Interest & Handling Charges	8,563	1,771
TOTAL REVENUES AND OTHER SUPPORT	<u>659,286</u>	<u>659,950</u>
EXPENSES BY DEPARTMENT (See Schedule 1)		
Ferry	453,564	382,729
Ferry Docks	42,302	79,064
Administration	163,614	168,404
Water	27,768	21,413
Parks	16,367	23,914
Roads	29,305	37,025
TOTAL EXPENSES	<u>732,920</u>	<u>712,550</u>
REVENUES EXCEEDING EXPENSES (LOSS)	<u>(73,634)</u>	<u>(52,600)</u>
OTHER INCOME		516
Interest Earned	15,220	23,436
Gain on Installment Sale (See Note E)	554	516
TOTAL OTHER INCOME	<u>15,774</u>	<u>23,952</u>
REVENUES EXCEEDING EXPENSES (LOSS)	<u>(\$57,859)</u>	<u>(\$28,385)</u>

HMC MANAGEMENT
Statement of Functional Expenses - Schedule 1
October 2007 - September 2008 with Comparative Totals for Prior Period (2007)

2008 EXPENSE	Ferry	Ferry Docks	--Department-- Administration	Water	Parks	Roads	2008 Total	2007 Total
Payroll (Wages, taxes, and benefits)	\$260,603		84,633	7,088	1,396	653	\$354,373	\$322,690
Major Repairs and Maintenance	29,537					13,334	42,871	53,231
Repairs and Maintenance	2,469	668	824	5,561	3,744	12,202	25,468	54,960
Insurance	41,096		22,438				63,534	62,538
Ferry Fuel	68,849						68,849	53,432
Professional Services			29,430	5,898			35,328	38,480
Miscellaneous Service & Supplies	9,053	1,658	7,466	1,962	6,385	1,521	28,045	24,809
Taxes and DNR Lease	3,665	611	2,816	640			7,732	5,365
Postage, Printing, Copying			7,777				7,777	8,880
Utilities	519	111	2,018	2,290	2,330		7,268	6,388
Bad Debt Expense			6,000				6,000	6,000
Total Expenses by Department before Depreciation	415,791	3,048	163,402	23,439	13,855	27,710	647,245	630,773
Depreciation	37,773	39,254	212	4,329	2,512	1595	85,675	81,777
Total Expenses by Department after Depreciation	453,564	42,302	163,614	27,768	16,367	29,305	\$732,920	\$712,550

HMC MANAGEMENT
Statement of Changes in Members' Equity
As of September 30, 2008 and 2007

	Members' Savings	Unrestricted Net	<u>Total Members' Equity</u>	
	Reserves	Assets	2008	2007
MEMBERS' EQUITY				
BEGINNING OF YEAR	\$290,872	1,316,934	1,607,806	1,636,455
Excess of Revenues over Expenses (Loss) before Other Income		(73,634)	(73,634)	(52,600)
Transfers from Operating Account to Savings Reserves	3,000	(3,000)	0	0
Allocation of Other Income				
- Interest Earned	10,970	4,250	15,220	23,435
- Gain on Installment Sale		554	554	516
MEMBERS' EQUITY	304,842	1,245,104	1,549,946	\$1,607,806
END OF YEAR				

HMC Management
Statement of Cash Flows
For the Years Ended September 2008 and 2007

	<u>2008</u>	<u>2007</u>
OPERATING ACTIVITIES		
Net Income (Loss)	(\$57,859)	(\$28,385)
Adjustments to reconcile Net Income to net cash provided by operations: Increase(Decrease)		
Transfer to Investment Account (Reserves)	(3,000)	(57,000)
Interest Earned (Investment Accounts)	(11,018)	(13,629)
Depreciation	85,675	82,610
Delinquent Accounts Receivable, net (SEE NOTE D)	10,128	63,678
Note Receivable	845	780
Accounts Receivable	(7,206)	78
Accounts Payable	(23,868)	28,579
Prepaid Assessments	905	283
Security Deposits, net	1,759	2,176
Net cash provided by Operating Activities	<u>(3,639)</u>	<u>79,170</u>
INVESTING ACTIVITIES		
Deferred Gain	(554)	(516)
Capital Additions/Improvements	<u>(30,827)</u>	<u>(36,911)</u>
Net cash provided by Investing Activities	<u>(31,381)</u>	<u>(37,427)</u>
Net cash increase(decrease) for period	<u>(35,020)</u>	<u>41,743</u>
Cash at beginning of period	<u>139,785</u>	<u>98,042</u>
Cash at end of period	<u><u>\$104,765</u></u>	<u><u>\$139,785</u></u>

HMC MANAGEMENT
Notes to Financial Statements
For the Fiscal Year Ended September 30, 2008

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 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 \$53,000. Management accepts this risk because Vanguard has not defaulted on any accounts.

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.

HMC MANAGEMENT
Notes to Financial Statements
For the Fiscal Year Ended September 30, 2008

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 thru 2005 to fairly value the property.

Member Assessments

HMC Management's members are subject to annual assessments (\$1200 per assessable unit in 2008) 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 Management considers these accounts receivable (active members) as fully collectable and, accordingly, does not deem it necessary to establish an allowance for uncollectible 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, 2008

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 are delinquent. Nonetheless, management has provided an estimate for doubtful accounts (delinquent accounts receivable). That account is reported at a net value and includes \$6,000 for uncollectable accounts in 2008 and \$4,883 in 2007.

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.