

HMC MANAGEMENT
AUDITED FINANCIAL STATEMENTS

For the Fiscal Year Ended September 30, 2004

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To the Board of Directors and Members
HMC Management
Herron Island, Washington

INDEPENDENT AUDITORS' REPORT

We have audited the accompanying Balance Sheet of **HMC Management** as of September 30, 2004 and the related Statements of Revenues, Expenses and Changes in Members' Equity, and Cash Flows for the year then ended. These financial statements are the responsibility of the Association's 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, 2004, and the results of its activities and its cash flows for the years then ended in conformity with generally accepted accounting principles. This report is intended solely for the information and use of (the specified parties) and is not intended to be and should not be used by anyone other than these specified parties.

Sincerely,

Doug Collier and Associates, P.S.
February 18, 2005

HMC MANAGEMENT

(A Homeowners' Association)

BALANCE SHEET

September 30, 2004

ASSETS

Cash and Cash Equivalents	\$	183,961
Accounts Receivable		75,202
Total Accounts Receivable		
Restricted Funds (Vanguard)		
Docks/Dolphins Reserves	\$	78,020
Dry Dock Reserves		46,387
Legal and Insurance Reserves		25,257
Road Reserves		7,990
Water Reserves		53,777
Total Restricted Funds		211,431
Certificate of Deposit		1,043
Property & Equipment		
Ferry		729,711
Ferry Major Repair & Dry Dock		48,650
Ferry Steering System		19,435
Ferry Dock & Repairs		1,232,386
Ferry Dock Dolphins		37,838
Equipment & Office Improvements		45,652
Small Boat Dock		30,459
Major Road Repairs		40,245
Less Accumulated Depreciation		(963,778)
Total Property & Equipment		1,220,598
Land		16,930

TOTAL ASSETS \$ 1,709,165

LIABILITIES & MEMBERS' EQUITY

Accounts Payable	\$	34,686
Prepaid Assessments		84,039
TOTAL LIABILITIES	\$	118,725
Members' Equity		1,590,440
TOTAL LIABILITIES & MEMBERS' EQUITY	\$	<u>1,709,165</u>

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

HMC MANAGEMENT

(A Homeowners' Association)

STATEMENT OF REVENUES & EXPENSES AND CHANGES IN MEMBERS' EQUITY

For the Fiscal Year Ended September 30, 2004

REVENUES

Annual Assessments	\$	352,340	
Special Assessments		21,600	
Ferry Fees		145,151	
Interest Income		13,011	
Miscellaneous		6,552	
TOTAL REVENUES			\$ 538,654

EXPENSES

Administrative			
Accounting & Payroll Service	\$	4,886	
Amortization & Depreciation		8,441	
Bad Debt		1,612	
Insurance		23,540	
Legal & Collection Fees		9,774	
Miscellaneous		3,924	
Office, Printing & Postage		8,424	
Salaries, Payroll Taxes, & Benefits		51,586	
State & County Taxes		1,933	
Telephone		2,082	
Total Administrative Expenses			116,202

Ferry Docks

Depreciation	34,594
Repairs & Maintenance	753
Parts & Supplies	6,813
Utilities	1,123

Total Ferry Docks Expenses

43,283

Ferry

Depreciation	44,410
Equipment	1,180
Fuel	28,486
Insurance	39,212
Major Repairs & Dry Dock	30,328
Routine Maintenance	9,008
Salaries, Payroll Taxes & Benefits	191,375
Taxes- Personal Property & Excise	3,095
Utilities, Supplies & Other	7,005

Total Ferry Expenses

354,099

Park Expenses

7,953

Road Expenses

12,039

Water Expenses

Salaries & Payroll Taxes	4,429
Repairs, Supplies, Utilities & Other	20,187

Total Water Expenses

24,616

TOTAL EXPENSES

558,192

Deficiency of Revenues over Expenses

(19,538)

Members' Equity on September 30, 2003

1,609,978

Members' Equity on September 30, 2004

\$ 1,590,440

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

HMC MANAGEMENT
(A Homeowners' Association)
STATEMENT OF CASH FLOWS

For the Fiscal Year Ended September 30, 2004

Cash Flows from Operating Activities

Deficiency of Revenue over Expenses	\$ (19,538)
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**Adjustments to reconcile Deficiency of Revenue over Expenses
to Cash Flows from Operating Activities:**

Amortization and Depreciation	\$ 88,206
Increase Accounts Receivable	(5,515)
Decrease in Prepaid Insurance	963
Increase in Accounts Payable	25,497
Increase in Prepaid Assessments	84,039

Net Cash Provided by Operating Activities	<u>193,190</u>
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Net Increase in Cash	173,652
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CASH AND CASH EQUIVALENTS ON SEPTEMBER 30, 2003	<u>222,783</u>
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CASH AND CASH EQUIVALENTS ON SEPTEMBER 30, 2004	<u><u>\$ 396,435</u></u>
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HMC MANAGEMENT
NOTES TO THE FINANCIAL STATEMENTS
For the Fiscal Year Ended September 30, 2004

**NOTE A - NATURE OF ORGANIZATION AND SUMMARY OF SIGNIFICANT
ACCOUNTING POLICIES**

Nature of Organization

HMC Management was incorporated on May 1, 1958, in the state of Washington. HMC Management is responsible for the operation and maintenance of the common property on Herron Island and the wharf of the corporation located at Herron, including the specific purpose of maintaining and operating the private ferry between the wharf at Herron and Herron Island. All island lot owners are members of HMC Management. There are approximately 369 members.

Accrual Basis

HMC Management's financial statements present financial position and results of operations on the accrual basis of accounting. Accrual accounting is the method of recording transactions, by which revenues and expenses are reflected in the accounts in the period in which they are considered to have been earned and incurred, respectively, whether or not such transactions have been finally settled by the receipt or payment of cash or its equivalent.

Cash and Cash Equivalents

The Association considers cash on deposit, cash on hand, money market funds (if any) to be cash equivalents.

Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires the board of directors 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 reporting period. Actual results could differ from those estimates.

Member Assessments

HMC Management's members are subject to annual assessments to provide funds for HMC Management's operating expenses, future capital acquisitions, and major repairs and replacements. Accounts receivable at the balance sheet date represents fees due from lot owners. HMC Management's policy is to retain legal counsel and place liens on the properties of lot owners whose assessments are 30 days or more delinquent. Any excess assessments at year-end are retained by HMC Management for use in the succeeding year.

HMC MANAGEMENT
NOTES TO THE FINANCIAL STATEMENTS
For the Fiscal Year Ended September 30, 2004

Income Taxes

Homeowners' associations may be taxed either as homeowners' associations or as regular corporations. HMC Management has elected to be taxed as homeowners' association. Under that election, the association is taxed on its nonexempt function income, such as interest earnings, at a flat rate of 30%. Exempt function income, which consists primarily of member assessments, is not taxable.

Property and Equipment

Property, plant, and equipment are stated at cost. All assets purchased for over \$500 are capitalized and depreciated over their useful life. Capitalized common property is depreciated over its estimated useful life using the straight-line method of depreciation. At acquisition, the estimated useful life of the ferry and ferry docks were 20 years and 40 years respectively. The estimated useful lives of capitalized equipment are five to seven years.

Assets acquired when the organization was first formed were not capitalized. This is a departure from generally accepted accounting principles. Its effect on HMC Management's financial position has not been determined, but it is considered immaterial due to the age of the assets.

Land

Property not capitalized includes, but is not limited to, land parcels acquired through foreclosure. At September 30, 2004 a total of twenty-one such parcels have been acquired.

A total of four lots have been deeded in lieu of paying the outstanding assessments to the organization. The value of these lots as of the balance sheet date was \$16,930. The organization plans to retain one lot. The other three lots are to be sold in the near future to recover their costs. Three of these lots are recorded at their assessed value of \$3,800, and the balance of the outstanding assessment was allocated to bad debt expense. The remaining lot is recorded at a cost (delinquent amount) of \$13,130.

NOTE B - ASSESSMENTS RECEIVABLE

Assessments receivable consists of general assessments which are used to maintain operations of HMC Management property and the ferry dock assessment, which was used to build the new ferry dock.

HMC MANAGEMENT
NOTES TO THE FINANCIAL STATEMENTS
For the Fiscal Year Ended September 30, 2004

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 conducted a study to determine the remaining useful lives of the components of common property and estimates of the costs of major repairs and replacements that may be required in the future. HMC Management currently sets aside funds for dry dock, docks and dolphins, legal and insurance, water system, roads, and a few other planned and unplanned expenses. If these funds are drained the corporation plans to borrow, increase maintenance assessments, or delay repairs and replacements until funds are available. The effect on future assessments has not been determined.

NOTE D – INSURANCE

HMC Management is an accrual basis corporation. Insurance is reported on cash basis. In prior years HMC Management has used the pure accrual method for reporting insurance by use of a prepaid insurance asset account. The Board of Directors has determined that they would like to see the insurance when paid for ease in budgeting for future periods. The amounts have been determined to be immaterial when looking at the financial statement in its entirety.