

# 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 Balance Sheet of HMC Management (a Washington State Homeowners Association) as of September 30, 2007, 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, 2007, 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  
January 15, 2008

# HMC MANAGEMENT

## Balance Sheet

As of September 30, 2007 and 2006

ASSETS	FY 2007	FY 2006
Current Assets		
Cash and Cash Equivalents (See Note A)		
Cash	\$ 138,653	\$96,970
Certificate of Deposit	1,132	1,072
Total Cash and Cash Equivalents	139,785	98,042
Accounts Receivable from Active Members	587	665
Total Current Assets	140,373	98,707
Long Term Assets		
Investment in Vanguard Funds (see Note B)	290,873	220,244
Delinquent Members Receivables, net (see Note D)	45,322	109,000
Note Receivable (See Note E)	18,435	19,215
Total Long Term Assets	354,630	348,459
Plant, Property and Equipment		
Land - Common Use (See Note A)	27,300	27,300
Fixed Assets		
Ferry/Docks	2,104,931	2,068,020
Water System	108,217	108,217
Small Boat Dock (Parks)	65,003	65,003
Roads	40,245	40,245
Office/Equipment	34,213	34,213
less Accumulated Depreciation	(1,203,543)	(1,121,928)
Total Net Fixed Assets	1,149,067	1,193,771
Total Plant, Property, and Equipment	1,176,367	1,221,071
TOTAL ASSETS	1,671,369	1,668,237
LIABILITIES AND MEMBERS' EQUITY		
LIABILITIES		
Short Term Liabilities		
Accounts Payable - Trade	36,414	7,835
Prepaid Assessments	5,095	4,812
Security Deposits	6,498	4,322
Total Short Term Liabilities	48,007	16,969
Long Term Liability		
Deferred Gain (See Note E)	15,556	16,073
Total Long Term Liability	15,556	16,073
TOTAL LIABILITIES	63,563	33,042

# HMC MANAGEMENT

## Balance Sheet

As of September 30, 2007 and 2006

	<b>FY 2007</b>	<b>FY 2006</b>
<b>MEMBERS' EQUITY</b>		
Unrestricted Balance	1,316,934	1,415,948
Board Designated (See Note B)		
Members' Savings Reserves	290,873	220,244
<b>TOTAL MEMBERS' EQUITY</b>	<b>1,607,807</b>	<b>1,636,192</b>
<b>TOTAL LIABILITIES AND MEMBERS' EQUITY</b>	<b>\$1,671,369</b>	<b>\$1,668,237</b>

**HMC MANAGEMENT**  
**Statement of Revenues and Expenses**  
**for the Years Ended September 30, 2007 and 2006**

	<b>FY 2007</b>	<b>FY 2006</b>
<b>REVENUES AND OTHER SUPPORT</b>		
General Assessments, net	\$456,328	\$419,416
Ferry Fees	152,057	147,796
Delinquent Accounts (Current Year)	31,112	21,319
Miscellaneous	13,043	3,798
Donation for Improvements	5,639	20,000
HMC Interest & Handling Charges	1,771	3,369
Small Boat Dock Assessment	0	38,733
<b>TOTAL REVENUES AND OTHER SUPPORT</b>	<b>659,950</b>	<b>654,432</b>
<b>EXPENSES BY DEPARTMENT (See Schedule 1)</b>		
Ferry	382,729	386,043
Ferry Docks	79,064	68,353
Administration	168,404	145,199
Water	21,413	35,004
Parks	23,914	10,851
Roads	37,025	20,506
<b>TOTAL EXPENSES</b>	<b>712,550</b>	<b>665,956</b>
<b>REVENUES EXCEEDING EXPENSES (LOSS)</b>	<b>(52,600)</b>	<b>(11,524)</b>
<b>OTHER INCOME</b>		
Interest Earned	23,436	18,229
Gain on Installment Sale (See Note E)	780	729
<b>TOTAL OTHER INCOME</b>	<b>24,216</b>	<b>18,958</b>
<b>REVENUES EXCEEDING EXPENSES (LOSS)</b>	<b>(\$28,385)</b>	<b>\$7,434</b>

See Independent Auditor's Report  
The Accompanying Notes are an Integral Part of these Financial Statements

**HMC MANAGEMENT**  
**Statement of Functional Expenses - Schedule 1**  
**October 2006 - September 2007 with Comparative Totals for Prior Period (FY2006)**

<b>FY 2007 EXPENSE</b>	<b>Ferry</b>	<b>Ferry Docks</b>	<b>Department Administration</b>	<b>Water</b>	<b>Parks</b>	<b>Roads</b>	<b>FY2007 Total</b>	<b>FY2006 Total</b>
Payroll (Wages, taxes, and benefits)	\$235,551		78,434	6,893	1,164	648	322,690	\$271,753
Major Repairs and Maintenance		42,706	10,525				53,231	59,474
Repairs and Maintenance	6,300	414		3,164	8,768	36,314	54,960	56,437
Insurance	40,186		22,352				62,538	63,318
Ferry Fuel	53,432						53,432	45,607
Professional Services			32,974	2,356	3,150		38,480	30,521
Misc Service & Supplies	8,610		6,448	2,321	7,430		24,809	28,601
Taxes and DNR Lease	878		4,487				5,365	9,771
Postage, Printing, Copying			8,880				8,880	8,108
Utilities		745	2,340	2,350	890	63	6,388	4,228
Bad Debt Expense							0	6,000
<b>Total Expenses by Department before Depreciation</b>	<b>344,956</b>	<b>43,865</b>	<b>166,440</b>	<b>17,084</b>	<b>21,402</b>	<b>37,025</b>	<b>630,773</b>	<b>583,819</b>
<b>Depreciation</b>	<b>37,773</b>	<b>35,199</b>	<b>1,964</b>	<b>4,329</b>	<b>2,512</b>		<b>81,777</b>	<b>82,137</b>
<b>Total Expenses by Department after Depreciation</b>	<b>382,729</b>	<b>79,064</b>	<b>168,404</b>	<b>21,413</b>	<b>23,914</b>	<b>37,025</b>	<b>712,550</b>	<b>\$662,956</b>

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

	Members' Savings Reserves	Unrestricted Net Assets	Total Members' Equity
<b>MEMBERS' EQUITY BEGINNING OF YEAR</b>	\$220,244	1,415,948	1,636,192
<b>Excess of Revenues over Expenses (Loss) before Other Income</b>		(52,600)	(52,600)
<b>Transfers from Operating Account to Savings Reserves</b>	57,000	(57,000)	0
<b>Allocation of Other Income</b>			
- Interest Earned	13,629	9,806	23,435
- Gain on Installment Sale		780	780
<b>MEMBERS' EQUITY END OF YEAR</b>	290,873	1,316,934	\$1,607,807

See Independent Auditor's Report  
The Accompanying Notes are an Integral Part of these Financial Statements

**HMC Management**  
**Statement of Cash Flows**  
October 2006 through September 2007

	<u>FY 2007</u>
<b>OPERATING ACTIVITIES</b>	
Net Income (Loss)	(\$28,385)
Adjustments to reconcile Net Income to net cash provided by operations: Increase(Decrease)	
Transfer to Investment Account (Reserves)	(57,000)
Interest Earned (Investment Accounts)	(13,629)
Depreciation, adjusted	82,611
Delinquent Accounts Receivable, net (SEE NOTE D)	63,678
Note Receivable	780
Accounts Receivable	78
Accounts Payable	28,579
Prepaid Assessments	283
Deposits, net	2,176
Net cash provided by Operating Activities	<u>79,171</u>
<b>INVESTING ACTIVITIES</b>	
Deferred Gain	(517)
Purchase of Generators	(36,911)
Net cash provided by Investing Activities	<u>(37,428)</u>
Net cash increase for period	41,743
Cash at beginning of period	98,042
Cash at end of period	<u><u>\$ 139,785</u></u>

**HMC MANAGEMENT**  
**Notes to Financial Statements**  
For the Fiscal Year Ended September 30, 2007

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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 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 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. The organization used lowest assessed values for 2001 thru 2005 to fairly value the property.



**HMC MANAGEMENT**  
**Notes to Financial Statements**  
For the Fiscal Year Ended September 30, 2007

**Member Assessments**

HMC Management's members are subject to annual assessments (\$1200 per assessable unit in 2007) 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.

**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 Vanguard Money Market accounts specified for those purposes. (See Note A)

**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.

**HMC MANAGEMENT**  
**Notes to Financial Statements**  
For the Fiscal Year Ended September 30, 2007

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 (ca. 5 years) include replacement of the dolphins and re-engine of the ferry. The cost of these projects has not been determined.

**NOTE D – Delinquent Accounts**

It is the position of the Board of Directors 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 \$6000 for uncollectable accounts in 2006, and \$4883 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.