

HMC MANAGEMENT

AUDITED FINANCIAL STATEMENTS

For the Fiscal Year Ended September 30, 2005

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April 24, 2006

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, 2005 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, 2005, 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.

HMC MANAGEMENT

(A Homeowners' Association)

BALANCE SHEET

September 30, 2005

ASSETS

Cash and cash equivalents	\$	169,757
Accounts receivable		30,416
Note receivable		19,942

Restricted Funds (Vanguard)

Docks/Dolphins reserves	\$	79,952
Dry dock reserves		25,223
Legal and insurance reserves		25,882
Road reserves		8,188
Water reserves		71,803

Total Restricted Funds 211,048

Certificate of deposit 1,047

Property & Equipment

Ferry	729,711
Ferry major repair and dry dock	48,650
Ferry steering system	19,435
Ferry dock and repairs	1,232,386
Ferry dock dolphins	37,838
Equipment and office improvements	41,985
Small boat dock	30,459
Major road repairs	40,245
Water system tank	108,217
Less accumulated depreciation	(1,048,621)

Total Property & Equipment 1,240,305

Land 27,300

TOTAL ASSETS \$ 1,699,815

LIABILITIES & MEMBERS' EQUITY

Accounts payable	\$	34,014
Prepaid assessments		91,790
Security deposit		2,148
Deferred gain		19,942

TOTAL LIABILITIES \$ 147,894

Members' Equity 1,551,921

TOTAL LIABILITIES & MEMBERS' EQUITY \$ 1,699,815

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, 2005***REVENUES**

Annual assessments	\$	409,269	
Special assessments		75,733	
Ferry fees		142,116	
Interest income		20,274	
Contract principal received		58	
Miscellaneous		3,672	
TOTAL REVENUES			\$ 651,122

EXPENSES

Administrative			
Accounting and payroll service	\$	5,544	
Amortization and depreciation		8,132	
Bad debt		428	
Insurance		22,292	
Legal and collection fees		3,129	
Miscellaneous		6,266	
Office, printing and postage		14,251	
Salaries, payroll taxes, and benefits		55,432	
State and county taxes		1,687	
Telephone		2,221	
Total Administrative Expenses			119,382
Ferry Docks			
Depreciation		35,200	
Repairs and maintenance		2,477	
Parts and supplies		1,151	
Utilities		1,101	
Total Ferry Docks Expenses			39,929
Ferry			
Depreciation		43,854	
Equipment		207	
Fuel		37,427	
Insurance		40,871	
Major repairs and dry dock		63,715	
Routine maintenance		15,147	
Salaries, payroll taxes and benefits		198,785	
Taxes- personal property and excise		3,978	
Utilities, supplies and other		6,005	
Total Ferry Expenses			409,989
Park Expenses			12,269
Road Expenses			20,275
Water Expenses			
Salaries and payroll taxes		4,808	
Repairs, supplies, utilities and other		15,932	
Water tank project		21,979	
Total Water Expenses			42,719
TOTAL EXPENSES			<u>644,563</u>

Revenues over expenses before infrequent item 6,559

Gain on sale of common property 16,317

Revenues over expenses after infrequent item 22,876

Members' Equity on September 30, 2004 1,590,440

Prior Period Adjustments (Note E) (61,395)

Members' Equity on September 30, 2005 \$ 1,551,921

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, 2005

Cash Flows from Operating Activities

Revenues over expenses	\$	22,876
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Adjustments to reconcile Revenue over Expenses to Cash Flows from Operating Activities:

Amortization and depreciation	\$	84,845
Increase in accounts receivable		(1,547)
Decrease in delinquent accounts receivable		(25,433)
Increase in notes receivable		(19,942)
Increase in security deposit		2,148
Decrease in accounts payable		(672)
Increase in prepaid assessments		7,751

Net Cash Provided by Operating Activities		<u>47,150</u>
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Investing Activities

Purchase of equipment	(108,217)
Disposal of assets	3,667
Deferred gain on sale of property	19,942

Net Cash Used by Investing Activities		<u>(84,608)</u>
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Net Decrease in Cash		<u>(14,582)</u>
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CASH AND CASH EQUIVALENTS ON SEPTEMBER 30, 2004		<u>396,434</u>
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CASH AND CASH EQUIVALENTS ON SEPTEMBER 30, 2005	\$	<u><u>381,852</u></u>
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The accompanying notes are an integral part of the financial statements.

HMC MANAGEMENT
NOTES TO THE FINANCIAL STATEMENTS
For the Fiscal Year Ended September 30, 2005

**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, 2005

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

HMC Management has several lots that have either "Park" status or are held for possible park use. We used the lowest assessed value for 2001-05, as a method to fairly value the property.

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.

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.

HMC MANAGEMENT
NOTES TO THE FINANCIAL STATEMENTS
For the Fiscal Year Ended September 30, 2005

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.

NOTE E – PRIOR PERIOD ADJUSTMENTS

Prior period adjustments were made to financial statements to reflect the following:

- 1) Valuation of land at its lowest average assessed value per Pierce County Assessors Office. A date range from 2001 through 2005 was used to come up with the average value. This ended in an adjustment to increase equity for \$10,370.
- 2) Delinquent accounts were written down by \$71,765 to better reflect those accounts that we feel to be reasonably collectable at year ended September 30, 2005.