

INDEPENDENT AUDITOR'S REPORT
FOR
HMC MANAGEMENT - 2013

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HMC FINANCIAL STATEMENTS AUDITED BY:

MICHAEL KANDER CPA

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, 2013 and 2012, 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, 2013 and 2012, and the results of operations for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The HMC Management Reserve Study on page 8, dated April 19, 2013, is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.


Michael J. Kander, CPA
University Place, WA
March 26, 2014

HMC MANAGEMENT
Statement of Financial Position
As of September 30, 2013 and 2012

ASSETS	2013	2012
Current Assets		
Cash and Cash Equivalents (See Note A)		
Checking (Operating Account)	\$ 290,801	\$ 132,842
Checking (Water Account)	46,057	27,428
Certificate of Deposit	1,056	1,056
Total Cash and Cash Equivalents	<u>337,913</u>	<u>161,326</u>
Accounts Receivable		
General Operating Assessments Receivable	14,092	24,294
Base Fees Receivable (Water System)	2,932	2,054
Other Receivable for Capital Expenditures	123,093	123,093
Total Accounts Receivable	<u>17,024</u>	<u>149,441</u>
Total Current Assets	<u>354,937</u>	<u>310,767</u>
Long Term and Other Assets		
Investment in Vanguard Funds (See Note B)	351,757	332,676
Land Acquired (use not determined)	30,000	40,000
Delinquent Members Receivables (See Note D)	54,731	10,297
less Allowance for Doubtful Accounts	(5,300)	
Prepaid Drydock Expenses (See Note E)	33,822	79,152
Prepaid Engine Maintenance Expenses (See Note E)	181,851	
Prepaid Expenses for Water Project	7,416	7,416
Total Long Term Assets	<u>646,861</u>	<u>469,542</u>
Plant, Property and Equipment		
Land - Common Use (See Note A)	25,600	27,300
Fixed Assets		
Ferry/Docks	2,108,732	2,108,732
Water System	108,217	108,217
Water Distribution System (See Note C & I)	1,718,140	1,262,742
Small Boat Dock (Parks)	266,683	249,799
Roads	57,292	31,895
Office/Equipment	38,559	38,559
less Accumulated Depreciation	(1,649,348)	(1,512,540)
Total Net Fixed Assets	<u>2,648,275</u>	<u>2,287,404</u>
Total Plant, Property, and Equipment, net	<u>2,673,875</u>	<u>2,314,704</u>
TOTAL ASSETS	<u><u>\$ 3,675,673</u></u>	<u><u>\$ 3,095,013</u></u>

Continued

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

HMC MANAGEMENT
Statement of Financial Position
As of September 30, 2013 and 2012

LIABILITIES AND MEMBERS' EQUITY

	<u>2013</u>	<u>2012</u>
LIABILITIES		
Short Term Liabilities		
Accounts Payable - Trade	\$ 3,263	\$ 17,793
Short Term Portion of USDA Loan (See Note I)	53,278	
Dry Dock Payable		67,644
Engine Maintenance Payable (See Note E)	56,647	
Prepaid Assessments - General	17,985	14,432
Prepaid Assessments - Water System	5,811	
Security Deposits	3,525	3,525
Total Short Term Liabilities	<u>140,509</u>	<u>103,393</u>
 Long Term Liability (See Note I)		
USDA Loan for Water Distribution System	<u>1,312,175</u>	<u>1,388,513</u>
Total Long Term Liability	<u>1,312,175</u>	<u>1,388,513</u>
 TOTAL LIABILITIES	 <u><u>1,452,684</u></u>	 <u><u>1,491,906</u></u>
 MEMBERS' EQUITY		
Unrestricted Balance	1,871,232	1,270,431
Board Designated for Engine Maintenance	181,851	
Board Designated for Capital and Major		
Repairs and Maintenance (See Note B)	<u>351,757</u>	<u>332,676</u>
 TOTAL MEMBERS' EQUITY	 <u><u>2,222,989</u></u>	 <u><u>1,603,107</u></u>
 TOTAL LIABILITIES AND MEMBERS' EQUITY	 <u><u>\$ 3,675,673</u></u>	 <u><u>\$ 3,095,013</u></u>

HMC MANAGEMENT
Statement of Activities
For the Years Ended September 30, 2013 and 2012

OPERATING and CAPITAL ACCOUNTS	<u>2013</u>	<u>2012</u>
REVENUES AND OTHER SUPPORT		
Member Assessments, gross (See Note A)		
General Operations	\$ 598,899	\$ 561,550
USDA Loan Semi-Annual Assessment	26,552	
Quarterly Water Assessments	95,406	95,030
Reserve Assessment	61,500	59,000
Total Assessments	<u>782,357</u>	<u>715,580</u>
Ferry Fees	174,847	191,464
Attorney Fee Invoicing	17,646	10,366
Miscellaneous Water Fees	1,920	-
Property Transfer Fees	5,950	-
HMC Interest & Handling Charges	17,286	12,087
Water Interest & Handling Charges	7,623	7,620
Miscellaneous HMC	1,964	2,450
Interest Earned (All Accounts)	84	379
TOTAL REVENUES AND OTHER SUPPORT	<u>1,009,677</u>	<u>939,946</u>
EXPENSES BY DEPARTMENT (See Schedule 1)		
Ferry	483,628	543,538
Ferry Docks	68,771	45,975
Administration	174,030	158,078
Water	161,507	70,649
Parks	22,186	21,557
Roads	31,188	20,271
TOTAL EXPENSES	<u>941,310</u>	<u>860,067</u>
REVENUES EXCEEDING EXPENSES (LOSS)	<u>68,367</u>	<u>\$ 79,878</u>
OTHER INCOME		
Special Assessment (Engine)	130,536	-
Special Assessment for Water Distribution		-
System - One Time Payment (See Note I)	410,780	-
Gain on Sale of Property	10,200	-
TOTAL OTHER INCOME	<u>551,516</u>	<u>-</u>
TOTAL REVENUES EXCEEDING EXPENSES	<u>\$ 619,883</u>	<u>\$ 79,878</u>

HMC MANAGEMENT

Statement of Functional Expenses - Schedule 1

October 2012 - September 2013 with Comparative Totals for Prior Period (2012)

2013 EXPENSE	--Department--					2013 Total	2012 Total
	Ferry	Ferry Docks	Administration	Water	Parks	Roads	
Payroll:							
Wages	\$ 242,322		\$ 85,550	\$ 42,778	\$ 1,993	\$ 600	\$ 342,557
Taxes	19,168		6,841	783	230		27,979
Benefits (Retirement and Medical)	46,476		11,475	238			65,512
Total Payroll	307,965		103,866	43,799	2,222	600	444,929
Major Repairs and Maintenance							
Amortized (See Note E)	45,330						57,842
Routine Repairs and Maintenance	6,293	8,107	850	7,406	1,431	23,235	55,705
Insurance	45,272	15,878	2,730			826	76,071
Ferry Fuel	66,047						72,199
Professional Services	1,087	3,892	38,873	11,962	4,026	3,402	43,307
Miscellaneous Service & Supplies	6,048	228	9,182	1,339	1,404	261	32,124
Taxes, Licenses, and DNR Lease	3,941	112	5,630	7,828			8,005
Postage, Printing, Copying	1,645		3,744	439			5,103
Utilities		1,272	3,206	3,096	506		6,822
USDA Loan Interest				16,913			-
Bad Debt Expense			5,300				
Total Expenses by Department before Depreciation	483,628	29,489	173,381	92,781	9,590	28,323	802,107
Depreciation	-	39,282	649	68,726	12,596	2,865	57,960
Total Expenses by Department after Depreciation	\$ 483,628	\$ 68,771	\$ 174,030	\$ 161,507	\$ 22,186	\$ 31,188	\$ 860,067

HMC Management
Statement of Cash Flows
For the Years Ended September 2013 and 2012

	<u>2013</u>	<u>2012</u>
OPERATING ACTIVITIES		
Net Income (Loss)	\$ 619,883	\$ 79,878
Adjustments to reconcile Net Income to net cash provided by operations: Increase/(Decrease)		
Depreciation	124,118	57,960
Delinquent Accounts Receivable (SEE NOTE D)	(44,434)	(4,619)
Allowance for Doubtful Accounts	5,300	-
Assessments/Base Fees Receivable	10,202	(20,398)
Base Fees Receivable (Water System)	(878)	-
Prepaid Maintenance Expenses (See Note E)	45,330	(10,162)
Prepaid Engine Overhaul Expenses (See Note E)	(181,851)	-
Prepaid Expenses for Water Project, Miscellaneous	7,416 137	22,517 201
Accounts Payable	(19,838)	5,275
Short Term Portion of USDA Loan	53,278	-
Dry Dock Maintenance Payable	(67,644)	67,444
Engine Maintenance Payable	56,647	-
Prepaid Assessments and Fees	3,553	(12,498)
Prepaid Assessments and Fees	5,811	-
Security Deposits, net	-	(2,888)
Net cash provided by Operating Activities	<u>617,031</u>	<u>182,709</u>
INVESTING ACTIVITIES		
Land Acquired	10,000	-
Land Common Use	1,700	-
Water Distribution System	(455,398)	1,265,420
Capital Additions/Improvements	(42,281)	184,796
Net cash used by Investing Activities	<u>(485,979)</u>	<u>1,450,216</u>
FINANCING ACTIVITIES		
Transfer from (to) Capital Account	(19,080)	58,570
Other Receivable for Capital Expenditures	123,094	(123,094)
Adjustment of USDA Loan Proceeds (See Note I)	17,860	-
Acquisition of Debt (See Notes C and H)	(76,338)	1,388,513
Net cash provided by Financing Activities	<u>45,536</u>	<u>1,323,989</u>
Net cash increase(decrease) for period	<u>176,588</u>	<u>56,482</u>
Cash at beginning of period	161,326	104,844
Cash at end of period	<u>\$ 337,914</u>	<u>\$ 161,326</u>

HMC MANAGEMENT
Statement of Changes in Members' Equity
As of September 30, 2013 and 2012

	<u>Total Members' Equity</u>			
	<u>Capital Account</u>	<u>Operating Account</u>	<u>2013</u>	<u>2012</u>
MEMBERS' EQUITY BEGINNING OF YEAR	\$ 332,676	\$ 1,270,818	\$ 1,603,494	\$ 1,525,906
Adjustment of Prior Year		(388)	(388)	(2,678)
Excess of Revenues over Expenses (Loss) before Other Income and Other Items		68,367	68,367	79,878
Other Income	410,780	140,736	551,516	-
Board Designated Transfers from Operating Account to Capital Account, net	19,080	(19,080)	-	-
MEMBERS' EQUITY END OF YEAR	\$ 762,536	\$ 1,460,841	\$ 2,222,989	\$ 1,603,107

HMC MANAGEMENT
RESERVE STUDY - April 19, 2013
for the period beginning October 1, 2013

Dept. Component	Useful Life	Remaining Useful Life	Current Avg.Cost	Future Avg.Cost
Site/Grounds				
Ashpalt Roads - Reair/Reurface	30	12	\$ 23,625	\$ 33,684
Gavel Roads/Lots - Maintenance	5	4	23,000	25,887
Small Boat Marina				
Docks/Floats - Replace	30	18	117,000	199,185
Docks Pilings - Replace	50	48	195,000	805,789
Trestle/Ramp - Replace	30	18	78,750	134,067
Gangway - Replace	30	18	7,000	11,917
Picnic/Recreation				
Play Equipment - Replace	20	4	50,000	56,275
Basketball Court - Repair/replace	25	24	20,000	40,656
Pavilion Roof - Replace	25	15	7,150	11,139
Community Building				
Siding - Replace	50	41	21,000	70,558
Roof - Replace	40	24	16,200	38,176
Septic - Replace	50	15	8,000	13,619
Equipment				
Utility Tractor/Mower - Replace	10	3	13,500	14,762
Dust/Water Truck - Replace	12	1	15,000	15,460
Ferry System				
Ferry Terminals - Inspect/Repair	2	0	22,000	23,340
Ferry Terminals - Paint	12	3	233,200	254,824
Ferry Terminals Cables - Replace	6	1	34,500	35,535
Ferry Terminal Structure - Replace	60	39	2,250,000	7,125,811
Ferry Ramp Dolphins - Replace	50	7	845,000	1,039,243
Ferry Ramp Generators - Replace	20	13	35,000	51,399
Ferry Vessel - Shipyard	2	1	92,500	95,275
Ferry Vessel - Overhaul Engines	5	5	35,000	40,575
Ferry Vessel - Replace Engines	50	0	165,000	723,344
Ferry Vessel - Overhaul Transmissior	5	5	13,000	15,071
Ferry Vessel - Replace Transmissions	25	0	35,000	73,282
Ferry Vessel - Replace	60	36	1,500,000	4,347,417
Legal Contingency Fund	NA	NA	\$ -	\$ 35,000

HMC MANAGEMENT
Notes to Financial Statements
For the Fiscal Year Ended September 30, 2013

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 an homeowners' association. 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 389 "assessable" units. For the water assessment 397 units were assessed. (Assessable units are single or contiguous units that are owned by one member.)

Basis of Accounting

The financial statements have been prepared in accordance with generally accepted government 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 \$100,000. Management accepts this risk because Vanguard has not defaulted on any accounts.

Fixed Assets

The Company capitalizes property and equipment over \$1,000 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, 2013

Land

HMC Management owns 13 lots that are for common use by the organization and by members and four lots for undetermined future use or sale. Original acquisition costs were not available. The organization used lowest assessed values for 2001 through 2005 to fairly value the property.

Additionally, HMC Management owns four tracts of land and beach front property for common use, but valuations are unknown.

Member Assessments

HMC Management's members are subject to annual assessments (\$1,672 per assessable unit in 2013) to provide funds for general operating expenses, future capital acquisitions, and major repairs and replacements. Assessments and accounts receivable at the balance sheet date represent fees and other charges due from owners. Delinquent owners' accounts are reported separately. HMC Management considers these receivables as fully collectable and, accordingly, does not deem it necessary to establish an allowance for uncollectable 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.

Special Assessments

A special assessment of \$333 was levied on all members for future, ferry engine repair.

A special water assessment in 2012 was designated for the new water distribution system to comply with state water regulations, financed by the USDA over 40 years at 2.5 percent. 92 Members elected to pay off their portion in full at the beginning (\$4,475) for a total of \$410,780. The remaining members are paying \$44.55 each quarter until the 40-year USDA loan is paid off.

The ferry engine assessment and the water assessments fully paid are reported as other income in the Statement of Activities to simplify and clarify the financial presentation. The income from the members who elected to pay over 40 years is reported in the Statement of Activities as operating income.

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.

In general, the association's tax returns may be selected for examination by tax authorities subject to a three-year statute of limitations for federal returns and four years for state excise tax returns.

HMC MANAGEMENT
Notes to Financial Statements
For the Fiscal Year Ended September 30, 2013

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)

Schedule of Reserves of September 30, 2013

Docks and Dolphins	\$127,478	Engine	\$6,000
Ship Yard	19,000	Water Truck	500
Legal	34,550	Ferry Replacement	1,000
Parks	13,816	Community Buildings	1,000
Roads	35,240	Ramp Inspections	6,000
Water	\$102,123	Ramp Cable Replacement	\$5,000

Total Board Designated Reserves: \$351,757

NOTE C – Future Major Repairs and Replacements

HMC Management's budget includes a portion for reserves to finance estimated future major repairs and replacements. In 2013 HMC Management had a study completed to determine the remaining useful lives of the components of all common property and future associated costs of major repairs and replacement, excluding the water system. (See supplemental financial data.) This study concluded the Reserve Fund is 14.7 percent funded for FY2014. In 2014 a Reserve Study will be required for the HMC infrastructure and separate one for the water system.

A project to modernize the water distribution system was begun in February 2012 and completed in March 2013, in order to comply with recent Washington State laws. HMC Management will continue to manage the water system.

HMC MANAGEMENT
Notes to Financial Statements
For the Fiscal Year Ended September 30, 2013

NOTE D – Delinquent Accounts

The position of the Board of Directors is that the Association will ultimately prevail against the remaining homeowners whose assessments and accounts are delinquent (without lien filings). Accordingly, only a minor provision for doubtful accounts was made in 2013.

NOTE E – Recurring Scheduled Maintenance

Recurring ferry maintenance is amortized over a two-year period for scheduled, dry dock maintenance (\$33,822 for each FY2013 and FY2014) and over a three-year period for scheduled engine overhaul (\$11,508 for each FY2011, FY2012 and FY2013). The FY2012 Prepaid Scheduled maintenance included two years of dry dock maintenance for FY2013 and FY2014 and one year of engine overhaul for FY2013. The FY2013 Prepaid Scheduled Maintenance included one year of dry dock maintenance (\$33,822.)

Also, the FY2013 Prepaid Scheduled Maintenance includes a one-time Engine Overhaul Maintenance estimated to cover the next six years beginning FY2014. (\$181,851) This was fully paid by October, 2013, largely as a result of the special engine assessment.

NOTE F – Retirement Contributions

HMC Maintenance matches employees' contributions for their 401(k) retirement plan. In 2013 the company paid \$ 13,595 and in 2012, \$15,611 for these employee benefits.

NOTE G – Federal and State Taxes

In general, the association's tax returns may be selected for examination by tax authorities subject to a three-year statute of limitations for federal returns and four years for state excise tax returns.

NOTE H – Subsequent Events

Litigation asserting that certain homeowners had adversely possessed a portion of roadway (owned by HMC) in front of their homes was dismissed in December, 2013. The settlement does not require either party to pay money to the other. However, total litigation fees accrued to HMC amounted to approximately \$22,000 – of which \$10,009 was accrued in 2013 financials. The remainder is accrued for 2014.

No other subsequent events were identified as of the report date.

HMC MANAGEMENT
Notes to Financial Statements
For the Fiscal Year Ended September 30, 2013

NOTE I – USDA Loan

HMC signed a promissory note on March 22, 2013, with USDA for financing a new water distribution system to comply with state regulations. The note is payable semi-annually (beginning September 2013) at 2.5 percent interest over 40 years. The amount payable semi-annually is \$26,639 which includes interest and principle. The note is for \$1,342,000 adjusted for one-time payments (\$410,780) and is secured by HMC property which includes land, roads, and improvements. This property is recorded as community property and does not have an associated value in Pierce County public assessor records. Therefore, this property does not appear on HMC financial statements.