

INDEPENDENT AUDITOR'S REPORT
FOR
HMC MANAGEMENT - 2010

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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, 2010 and 2009, 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, 2010 and 2009, 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 estimated the remaining lives and replacement costs of only the docks and dolphins but not all 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
February 15, 2011

HMC MANAGEMENT

Balance Sheet

As of September 30, 2010 and 2009

ASSETS	2010	2009
Current Assets		
Cash and Cash Equivalents (See Note A)		
Cash	\$ 98,748	\$ 97,900
Certificate of Deposit	1,030	1,006
Total Cash and Cash Equivalents	99,778	98,906
Accounts Receivable from Active Members	676	625
Prepaid Scheduled Periodic Maintenance	126,470	-
Total Current Assets	226,924	99,531
Long Term and Other Assets		
Investment in Vanguard Funds (see Note B)	423,135	361,739
Land Acquired (See Note D)	30,000	30,000
Delinquent Members Receivables, net (see Note D)	20,754	14,735
Note Receivable (See Note E)	-	11,683
Total Long Term Assets	473,889	418,157
Plant, Property and Equipment		
Land - Common Use (See Note A)	27,300	27,300
Fixed Assets		
Ferry/Docks	2,108,732	2,108,732
Water System	108,217	108,217
Small Boat Dock (Parks)	65,003	65,003
Roads	31,895	31,895
Office/Equipment	35,313	35,313
less Accumulated Depreciation	(1,413,691)	(1,338,509)
Total Net Fixed Assets	935,469	1,010,651
Total Plant, Property, and Equipment, net	962,769	1,037,951
TOTAL ASSETS	\$ 1,663,582	\$ 1,555,639
LIABILITIES AND MEMBERS' EQUITY		
LIABILITIES		
Short Term Liabilities		
Future Periodic Maintenance (See Note F)	\$ 126,470	\$ -
Accounts Payable - Trade	16,332	10,227
Prepaid Assessments	18,648	15,869
Security Deposits	9,207	8,207
Total Short Term Liabilities	170,658	34,303
Long Term Liability		
Deferred Gain (See Note E)	-	11,699
Total Long Term Liability	-	11,699
TOTAL LIABILITIES	\$ 170,658	\$ 46,002

HMC MANAGEMENT
Balance Sheet
As of September 30, 2010 and 2009

Continued

	<u>2010</u>	<u>2009</u>
MEMBERS' EQUITY		
Unrestricted Balance	\$ 1,022,643	\$ 1,135,006
Board Designated for Capital and Major Repairs and Maintenance (See Note B)	<u>470,281</u>	<u>374,631</u>
TOTAL MEMBERS' EQUITY	<u>1,492,924</u>	<u>1,509,637</u>
TOTAL LIABILITIES AND MEMBERS' EQUITY	<u>\$ 1,663,582</u>	<u>\$ 1,555,639</u>

HMC MANAGEMENT
Statement of Revenues and Expenses
For the Years Ended September 30, 2010 and 2009

	2010	2009
REVENUES AND OTHER SUPPORT		
General Assessments, gross (See Note A)		
Operations	\$ 534,400	\$ 535,900
Reserves	61,100	61,100
Total General Assessments	595,500	597,000
Ferry Fees	163,009	165,314
Delinquent Accounts (Other Charges)	15,762	14,519
Miscellaneous	9,061	5,815
HMC Interest & Handling Charges	12,111	11,678
Interest Earned (All Accounts)	1,288	5,499
TOTAL REVENUES AND OTHER SUPPORT	796,732	799,825
EXPENSES BY DEPARTMENT (See Schedule 1)		
Ferry	476,466	516,584
Ferry Docks	86,530	45,589
Administration	194,053	180,224
Water	37,909	41,797
Parks	12,334	12,660
Roads	17,298	35,838
TOTAL EXPENSES	824,590	832,692
REVENUES EXCEEDING EXPENSES (LOSS)	(27,858)	(32,866)
OTHER INCOME		
Gain on Installment Sale (See Note E)	11,146	516
TOTAL OTHER INCOME	11,146	516
UNUSUAL LOSS		
Exchange of land for delinquent accounts	-	(10,746)
REVENUES EXCEEDING EXPENSES (LOSS)	\$ (16,712)	\$ (43,096)

HMC MANAGEMENT
Statement of Functional Expenses - Schedule 1
October 2009 - September 2010 with Comparative Totals for Prior Period (2009)

2010 EXPENSE	--Department--						2010 Total	2009 Total
	Ferry	Ferry Docks	Administration	Water	Parks	Roads		
Payroll (Wages, taxes, and benefits)	\$ 323,559	\$ -	\$ 90,633	\$ 7,524	\$ 2,127	\$ 1,200	\$ 425,043	\$ 373,326
Repairs and Maintenance	12,132	17,980	2,514	5,466	3,427	14,199	55,717	146,927
Insurance	42,110	-	27,454	-	-	-	69,564	67,499
Ferry Fuel	59,845	-	-	-	-	-	59,845	48,082
Professional Services	715	24,689	48,101	1,182	-	-	74,687	36,250
Miscellaneous Service & Supplies	7,307	2,509	5,954	14,609	3,308	180	33,869	39,063
Taxes and DNR Lease	3,575	313	2,853	1,648	-	123	8,512	12,453
Postage, Printing, Copying	-	-	6,795	-	-	-	6,795	6,267
Utilities	691	1,404	3,171	3,151	960	-	9,376	10,404
Bad Debt Expense	-	-	6,000	-	-	-	6,000	6,000
Total Expenses by Department before Depreciation	449,933	46,896	193,474	33,580	9,822	15,703	749,408	746,270
Depreciation	26,533	39,634	579	4,329	2,512	1,595	75,182	86,422
Total Expenses by Department after Depreciation	\$ 476,466	\$ 86,530	\$ 194,053	\$ 37,909	\$ 12,334	\$ 17,298	\$ 824,590	\$ 832,692

HMC MANAGEMENT
Statement of Changes in Members' Equity
As of September 30, 2010 and 2009

	<u>Total Members' Equity</u>			
	<u>Capital Account</u>	<u>Unrestricted Net Assets</u>	<u>2010</u>	<u>2009</u>
MEMBERS' EQUITY BEGINNING OF YEAR	\$ 374,631	\$ 1,135,005	\$ 1,509,636	\$ 1,546,731
Excess of Revenues over Expenses (Loss) before Other Income and Other Items	-	(27,858)	(27,858)	(26,866)
Board Designated Transfers from Operating Account to Savings Reserves	95,650	(95,650)	-	-
Allocation of Other Income				
- Unusual Loss	-	-	-	(10,745)
- Gain on Installment Sale	-	11,146	11,146	516
MEMBERS' EQUITY END OF YEAR	\$ 470,281	\$ 1,022,643	\$ 1,492,924	\$ 1,509,636

HMC Management
Statement of Cash Flows
For the Years Ended September 2010 and 2009

	<u>2010</u>	<u>2009</u>
OPERATING ACTIVITIES		
Net Income (Loss)	\$ (27,858)	\$ (32,866)
Adjustments to reconcile Net Income to net cash provided by operations: Increase(Decrease)		
Loss on Acquiring Land (SEE NOTE D)	-	10,746
Depreciation	75,182	86,422
Delinquent Accounts Receivable, net (SEE NOTE D)	(6,019)	4,331
Accounts Receivable	(51)	7246
Prepaid Scheduled Periodic Maintenance (See Note Below)	-	-
Miscellaneous	(110)	1,842
Accounts Payable	6,105	(2,319)
Prepaid Assessments	2,779	9,869
Security Deposits, net	1,000	(50)
Net cash provided by Operating Activities	<u>51,028</u>	<u>77,975</u>
INVESTING ACTIVITIES		
Note Receivable	11,682	5,884
Gain/Deferred Gain on Note Receivable	(501)	(516)
Land Acquired (Exchange)	-	(30,000)
Capital Additions/Improvements	-	(1,100)
Net cash provided by Investing Activities	<u>11,181</u>	<u>(25,732)</u>
FINANCING ACTIVITIES		
Transfers to Investment Account (Reserves)	(61,337)	(58,102)
Net cash used by Investing Activities	<u>(61,337)</u>	<u>(58,102)</u>
Net cash increase(decrease) for period	<u>872</u>	<u>(5,859)</u>
Cash at beginning of period	<u>98,906</u>	<u>104,765</u>
Cash at end of period	<u>\$ 99,778</u>	<u>\$ 98,906</u>

Note:

The Establishment of the Prepaid Maintenance account is offset by the liability (Future Maintenance), so that the net effect for these years is zero.

HMC MANAGEMENT
Notes to Financial Statements
For the Fiscal Year Ended September 30, 2010

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 396 "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 account 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 \$173,000. 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, 2010

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 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 (\$1500 per assessable unit in 2010) 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 due from active owners, excluding assessments on delinquent accounts. HMC Management considers these receivables (active members) 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.

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.

Prepaid Recurring Maintenance

Ferry maintenance is amortized over a two year period for dry dock scheduled maintenance (\$91,948 total, \$45,974 each year), beginning FY2011, and over three years for the scheduled engine overhaul (\$34,523 total, \$11,508 each year), beginning FY2011.

HMC MANAGEMENT
Notes to Financial Statements
For the Fiscal Year Ended September 30, 2010

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, maintenance, 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 and constitute a majority of the board designated members' equity. (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 all 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, at an undetermined cost, in order to comply with recent Washington State laws.

A recent marine engineering study concluded:

- The two steel draw spans need repairs at a cost of \$212,000, although a time line was not specified. The report classified these repairs as "high priority."
- The piles at the homeowners dock marina need replacing within the next two years at a cost of approximately \$250,000.
- The dolphins in place have a useful life of 10-15 years from 2010.

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). However, in 2009 and 2010 the delinquent accounts receivable, because of lien filings, was reported at a net value and included \$6,000 for uncollectible accounts for each year.

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 \$10,839 which was paid in July, 2010.

HMC MANAGEMENT
Notes to Financial Statements
For the Fiscal Year Ended September 30, 2010

NOTE F – Subsequent Event

The scheduled dry dock and engine overhaul maintenance, completed in September 2010, was paid in October 2010.