

JUL 16 2013

# The Mediterranean Villas Homeowners Association



*Audit Report  
Financial Statements  
&  
Supplementary Information  
December 31, 2012*

*Prepared by:*

*Cagianut & Company*

CERTIFIED PUBLIC ACCOUNTANT

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*Members -* Community Associations Institute – Washington State  
Washington Society of Certified Public Accountants  
American Institute of Certified Public Accountants

## *Independent Auditors' Report*

To the Board of Directors and Members  
The Mediterranean Villas Homeowners Association  
Pasco, Washington

### **Report on the Financial Statements**

We have audited the accompanying financial statements of The Mediterranean Villas Homeowners Association, which comprise the balance sheet as of December 31, 2012, and the related statements of revenues, expenses and changes in fund balances and cash flows for the year then ended and the related notes to the financial statements.

### **Association's Responsibility for the Financial Statements**

The Association is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditor's Responsibility**

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 involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### **Opinion**

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Mediterranean Villas Homeowners Association as of December 31, 2012, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

#### Other Matter - Required Supplementary Information

Our audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. We have not applied procedures to determine whether the funds designated for future repairs and replacements are adequate to meet such future costs because that determination is outside the scope of our audit.

Accounting principles generally accepted in the United States of America [GAAP] require that the Supplementary Information on Future Major Repairs be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Financial Accounting Standards Board, who considers it to be an essential part of financial reporting and for placing the basic financial statements and related notes in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

*Cagianut & Company, CPA*

Bellevue, Washington

June 24, 2013

The Mediterranean Villas Homeowners Association

Balance Sheet  
December 31, 2012

	OPERATING FUND	REPLACEMENT FUND	TOTAL
<b>ASSETS</b>			
Cash, including interest bearing deposits	\$ 143,715	\$ 257,443	\$ 401,158
Assessments Receivable	9,127		9,127
Less: Allowance for Bad Debts	(4,787)		(4,787)
<b>TOTAL ASSETS</b>	<b>\$ 148,055</b>	<b>\$ 257,443</b>	<b>\$ 405,498</b>
 <b>LIABILITIES AND FUND BALANCES</b>			
<b>LIABILITIES</b>			
Accounts Payable	\$ 10,308		\$ 10,308
Assessments Received in Advance	11,842		11,842
Income Taxes Payable	208		208
<b>TOTAL LIABILITIES</b>	<b>22,358</b>		<b>22,358</b>
 <b>FUND BALANCES</b>			
Operating	125,697		125,697
Replacement		\$ 257,443	257,443
<b>TOTAL FUND BALANCES</b>	<b>125,697</b>	<b>257,443</b>	<b>383,140</b>
<b>TOTAL LIABILITIES AND FUND BALANCES</b>	<b>\$ 148,055</b>	<b>\$ 257,443</b>	<b>\$ 405,498</b>

See Notes to the Financial Statements

**The Mediterranean Villas Homeowners Association**  
Statement of Changes in Fund Balances  
For the Year Ended December 31, 2012

	OPERATING FUND	REPLACEMENT FUND	TOTAL
Balance at the Beginning of the Year	\$ 116,159	\$ 191,900	\$ 308,059
Transfer Between Funds	(40,000)	40,000	
Excess <Deficiency> of Revenues over Expenses	49,538	25,543	75,081
Balance at the End of the Year	<u>\$ 125,697</u>	<u>\$ 257,443</u>	<u>\$ 383,140</u>

See Notes to the Financial Statements

**The Mediterranean Villas Homeowners Association**  
Statement of Revenues and Expenses  
For the Year Ended December 31, 2012

	OPERATING FUND	REPLACEMENT FUND	TOTAL
<b>REVENUES</b>			
Assessments	\$ 225,595	\$ 24,480	\$ 250,075
Late & NSF Fees	1,983		1,983
RV/Storage	7,137		7,137
Fines/ HO Interest	938		938
Interest	42	1,063	1,105
Initial Contributions	500		500
Miscellaneous	1,264		1,264
<b>TOTAL REVENUES</b>	<b>237,459</b>	<b>25,543</b>	<b>263,002</b>
<b>EXPENSES</b>			
Accounting & Tax Preparation	200		200
Bad Debts	4,787		4,787
Electricity	1,503		1,503
Federal Taxes	208		208
Insurance	6,786		6,786
Landscape	98,009		98,009
Management/Bookkeeping	11,700		11,700
Miscellaneous	1,365		1,365
Real Property Taxes	632		632
Repairs & Maintenance	33,249		33,249
Reserve Study	2,850		2,850
Resident Activities	1,348		1,348
Seasonal Decorations	946		946
Water & Sewer	24,338		24,338
<b>TOTAL EXPENSES</b>	<b>187,921</b>		<b>187,921</b>
<b>EXCESS &lt;DEFICIENCY&gt; OF REVENUES OVER EXPENSES</b>	<b>\$ 49,538</b>	<b>\$ 25,543</b>	<b>\$ 75,081</b>

See Notes to the Financial Statements

**The Mediterranean Villas Homeowners Association**  
Statement of Cash Flows  
For the Year Ended December 31, 2012

	OPERATING FUND	REPLACEMENT FUND	TOTAL
<i>Cash Flows from Operating Activities:</i>			
Cash from Assessments	\$ 220,059	\$ 24,480	\$ 244,539
Interest Received	42	1,063	1,105
Miscellaneous Income	11,822		11,822
Cash Paid for Services and Products	(172,618)		(172,618)
Net Increase <Decrease> in Cash from Operating Activities	59,304	25,543	84,847
Net Increase <Decrease> in Cash	19,304	65,543	84,847
Cash, including interest bearing deposits, at the Beginning of Year	124,411	191,900	316,311
Cash, including interest bearing deposits, at the End of Year	<u>\$ 143,715</u>	<u>\$ 257,443</u>	<u>\$ 401,158</u>

Reconciliation of Excess <Deficiency> of Revenues over Expenses to Net Cash Received by Operations:

Excess <Deficiency> of Revenues over Expenses	\$ 49,538	\$ 25,543	\$ 75,081
Increased Assessments Receivable	(1,164)		(1,164)
Increased Bad Debt Allowance	4,787		4,787
Increased Accounts Payable	10,308		10,308
Decreased Prepaid Assessments	(4,372)		(4,372)
Increased Taxes Payable	208		208
Net Increase <Decrease> in Operating Cash	<u>\$ 59,304</u>	<u>\$ 25,543</u>	<u>\$ 84,847</u>

See Notes to the Financial Statements

## The Mediterranean Villas Homeowners Association

Notes to the Financial Statements  
December 31, 2012

### NOTE 1 - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### General

The Mediterranean Villas Homeowners Association was incorporated September 19, 2002 in the state of Washington as a nonprofit corporation. The Association is responsible for the operation and maintenance of the common property. This is a planned residential development located in Pasco, Washington that is still in buildout. At full buildout there should be 229 units. As of December 31, 2012 there were 211 units.

#### Accounting Method

The Association prepares its statements on the accrual basis of accounting whereby income and expenses are recognized when earned and incurred. Fund accounting is employed to properly account for the monies. The Operating Fund is used to pay for all utility, insurance, general maintenance, landscaping, and administrative obligations of the Association. The Replacement Fund has been established to meet the replacement and major repair obligations of the Association with regard to the common area components.

#### Capitalization Policy

Replacements and improvements to the real property are not capitalized on the books of the Association as the Board does not have the right to sell the common areas and keep the proceeds. Property and equipment acquired by the Association are recorded at cost. The property is depreciated over its estimated useful lives using the straight line method of depreciation. There is no capitalized property at the end of the year.

#### Assessments Receivable

Association members are subject to assessments to provide funds for the Association's operating expenses, future capital acquisitions, and major repairs and replacements. Assessments receivable at the balance sheet date represent fees due from unit owners. The Association's Declaration provides for various collection remedies for delinquent assessments including the filing of liens, foreclosing on the unit owner, and obtaining judgment on the assets of the unit owner. The Association uses the allowance method to account for uncollectible assessments receivable.

#### Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that 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.

#### Cash, including Interest Bearing Deposits

For purposes of the statement of cash flows, Cash, including Interest Bearing Deposits, includes cash on hand, funds on deposit with financial institutions, and investments with original maturities of three months or less.

#### Investments

Investments include certificates of deposit with original maturities over ninety days. These are level one type investments, classified as such when that investment is quoted in an active market and is measured at the unadjusted quoted market price.

#### Date of Review

In preparing the financial statements, the Association has evaluated events and transactions for potential recognition or disclosure through the date of the audit report, which is the date that the financial statements were available to be issued.

## The Mediterranean Villas Homeowners Association

Notes to the Financial Statements  
December 31, 2012

### NOTE 2 - REPLACEMENT FUNDING PROGRAM

The Association is currently funding replacement reserve accounts for the future major repair and replacement of Association common areas as disclosed in Note 1. Accumulated funds are held in separate accounts and are generally not available for operating purposes. The funding is based upon a professional reserve study approved by the board of directors.

Funds are being accumulated in the replacement fund based on estimates of future needs for repairs and replacements of common property components. Actual expenditures may vary from the estimated future expenditures, and variations may be material. Therefore, the amounts accumulated in the replacement fund may not be adequate to meet all future needs for major repairs and replacements. If additional funds are needed, the Association has the right, subject to certain legal limitations, to increase assessments, pass special assessments, or delay replacement if these funds are found to be inadequate for all future costs.

### NOTE 3 - FEDERAL INCOME TAXES

Associations may be taxed either as homeowners associations or as regular corporations. For the current year the Association elected to file as a homeowners association using form 1120-H under Internal Revenue Code Section 528. Under that Section, the Association is not taxed on income and expenses related to its exempt purpose, which is the acquisition, construction, management, maintenance and care of Association property. Net nonexempt function income which includes interest, user fees and revenues from non-members is taxed at 30%. Certain expenses were allocated to offset a portion of the taxable income.

The Association's federal tax return is subject to audit by the Internal Revenue Service. The tax returns for the current and prior two fiscal years remain open for examination by the IRS. In evaluating the Association's tax positions and accruals, the Association believes that its estimates are appropriate based on the current facts and circumstances.

### NOTE 4 - OWNERS' ASSESSMENTS

Monthly assessments to owners were \$100 per unit. Of this amount, a portion was designated to the replacement fund.

The annual budget and owners' assessments are determined by the Board of Directors, within certain restrictions. The Association retains excess operating funds at the end of the year, if any, for use in future operating periods.

### NOTE 5 - UNINSURED CASH BALANCES

The Association's cash deposits are with various financial institutions. Beginning January 1, 2013, noninterest bearing accounts are no longer insured separately by FDIC. Instead, all accounts in one financial institution are combined and the maximum FDIC insurance amount per bank is \$250,000. At the end of the year, bank balances exceeded the new FDIC limitation by over \$81,000.

**The Mediterranean Villas Homeowners Association**

December 31, 2012

Supplementary Information on Future Major Repairs  
and Replacements  
(Unaudited)

*A level 1 reserve study was prepared on October 29, 2012 by J2 Building Consultants, Inc. for the period beginning August 1, 2012 to estimate the remaining useful lives and the replacement costs of the components of common property. The estimates were based on current estimated replacement costs. Funding requirements consider an annual inflation rate of 2.0% and interest of 0.2%, net of taxes, on amounts funded for future major repairs and replacements. The following table is based on the study and presents significant information about the components of common property.*

Component	Estimated Remaining Useful Life	Estimated Current Replacement Costs	Fund Balance at Year End
<b>Amenities</b>			
Signage - repair/renew allowance	3 yrs.	\$ 2,677	
Exterior lighting replacement allowance	6 yrs.	2,274	
Palazzo Interior Paint	3 yrs.	2,677	
Palazzo Heat Pump Replacement	13 yrs.	4,707	
Palazzo Appliance replacement	10 yrs.	1,601	
Replace Palazzo light fixtures & fans - allowance	8 yrs.	947	
Palazzo Kitchen & Bath refurbish	18 yrs.	5,057	
Palazzo window glazing replacement allowance	13 yrs.	1,961	
Mail Box replacement allowance 1	13 yrs.	3,922	
Mail Box replacement allowance 2	23 yrs.	4,790	
Hot Water tank replacement - Palazzo	4 yrs.	546	
RV storage repair allowance - gate/grading	3 yrs.	1,606	
<b>Roads and Curbs</b>			
Emulsion coat & strip parking areas	2 yrs.	4,565	
Curb replacement allowance 1	12 yrs.	2,563	
Curb replacement allowance 2	20 yrs.	3,008	
Curb replacement allowance 3	28 yrs.	3,529	
<b>Grounds</b>			
Plant replacement/trimming	5 yrs.	13,929	
Irrigation repairs - valves/timers	7 yrs.	15,077	
Fencing repair allowance	2 yrs.	1,574	
Replacement of Wood fencing	18 yrs.	80,913	
<b>Partition Patio Wall Repairs</b>			
Allowance for repairs 111 total walls	3 yrs.	8,565	
<b>Exterior Painting</b>			
Phase 1 Ext wall - Siliconized permeable coating	14 yrs.	266,029	
Phase 2 Ext wall - Siliconized permeable coating	19 yrs.	293,983	
Phase 3 Ext wall - Siliconized permeable coating	24 yrs.	324,875	
1/3 of complex trim repainted allowance	2 yrs.	16,660	
Second 1/3 of trim paint	4 yrs.	17,340	
Third 1/3 of trim paint	6 yrs.	18,047	
<b>Roof Covering</b>			
Replace Palazzo & Pavilion roofs only	20 yrs.	10,865	
<b>Gas Vents</b>			
Replace 1/2 of roof mid gas B vents - allowance	18 yrs.	46,236	
Replace second half/roof med gas B vents	24 yrs.	52,126	
<b>TOTAL</b>			\$ 257,443

Percent Funded as of August 1, 2012 - 132%