

The Mediterranean Villas Homeowners Association

Audit Report Financial Statements & Supplementary Information

December 31, 2013

**Cagianut & Company
CERTIFIED PUBLIC ACCOUNTANT
www.hoacpa.com**

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, 2013, and the related Statement of Changes in Fund Balances, Statement of Revenues and Expenses and Statement of 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, 2013, 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.

Cagianet & Company, CPA

Bellevue, Washington

February 24, 2014

The Mediterranean Villas Homeowners Association

Balance Sheet
December 31, 2013

	<u>OPERATING FUND</u>		<u>REPLACEMENT FUND</u>		<u>TOTAL</u>
ASSETS					
Cash, including interest bearing deposits	\$ 189,062	\$	94,885	\$	283,946
Investments			190,337		190,337
Assessments Receivable	6,064				6,064
Prepaid Income Taxes	115				115
TOTAL ASSETS	<u>\$ 195,241</u>	\$	<u>285,222</u>	\$	<u>480,463</u>
 LIABILITIES AND FUND BALANCES					
LIABILITIES					
Accounts Payable	\$ 8,293	\$		\$	8,293
Assessments Received in Advance	19,166				19,166
Other Liability	325				325
TOTAL LIABILITIES	<u>27,783</u>				<u>27,783</u>
 FUND BALANCES					
Operating	167,457				167,457
Replacement		\$	285,222		285,222
TOTAL FUND BALANCES	<u>167,457</u>		<u>285,222</u>		<u>452,679</u>
TOTAL LIABILITIES AND FUND BALANCES	<u>\$ 195,241</u>	\$	<u>285,222</u>	\$	<u>480,463</u>

See Notes to the Financial Statements

The Mediterranean Villas Homeowners Association
Statement of Changes in Fund Balances
For the Year Ended December 31, 2013

	OPERATING FUND	REPLACEMENT FUND	TOTAL
Balance at the Beginning of the Year	\$ 125,697	\$ 257,443	\$ 383,140
Excess <Deficiency> of Revenues over Expenses	41,760	27,779	69,539
Balance at the End of the Year	<u>\$ 167,457</u>	<u>\$ 285,222</u>	<u>\$ 452,679</u>

See Notes to the Financial Statements

The Mediterranean Villas Homeowners Association
Statement of Revenues and Expenses
For the Year Ended December 31, 2013

	OPERATING FUND	REPLACEMENT FUND	TOTAL
REVENUES			
Assessments	\$ 230,185	\$ 26,790	\$ 256,975
Late & NSF Fees	1,589		1,589
RV/Storage	7,621		7,621
Interest - Delinquencies	1,009		1,009
Interest		989	989
Initial Contributions	500		500
Miscellaneous	1,166		1,166
TOTAL REVENUES	<u>242,070</u>	<u>27,779</u>	<u>269,849</u>
EXPENSES			
Audit & Tax Preparation	2,000		2,000
Bad Debts	1,827		1,827
Electricity	1,197		1,197
Federal Taxes	177		177
Insurance	8,083		8,083
Landscape	110,928		110,928
Management/Bookkeeping	12,600		12,600
Miscellaneous	1,080		1,080
Postage & Copies	1,508		1,508
Professional Fees	1,346		1,346
Real Property Taxes	822		822
Repairs & Maintenance	30,209		30,209
Resident Activities	598		598
Seasonal Decorations	1,075		1,075
Water & Sewer	26,859		26,859
TOTAL EXPENSES	<u>200,309</u>		<u>200,309</u>
EXCESS <DEFICIENCY> OF REVENUES OVER EXPENSES	<u>\$ 41,760</u>	<u>\$ 27,779</u>	<u>\$ 69,539</u>

See Notes to the Financial Statements

The Mediterranean Villas Homeowners Association
Statement of Cash Flows
For the Year Ended December 31, 2013

	OPERATING FUND	REPLACEMENT FUND	TOTAL
<i>Cash Flows from Operating Activities:</i>			
Cash from Assessments	\$ 240,571	\$ 26,790	\$ 267,361
Interest Received		989	989
Miscellaneous Income	11,885		11,885
Income Taxes Paid	(208)		(208)
Cash Paid for Services and Products	(206,901)		(206,901)
Net Increase <Decrease> in Cash from Operating Activities	45,347	27,779	73,126
<i>Cash Flows from Investing Activities:</i>			
Purchase of Investments		(137,572)	(137,572)
Net Increase <Decrease> in Cash	45,347	(109,794)	(64,447)
Cash, including interest bearing deposits, at the Beginning of Year	143,715	204,678	348,393
Cash, including interest bearing deposits, at the End of Year	<u>\$ 189,062</u>	<u>\$ 94,885</u>	<u>\$ 283,946</u>

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

Excess <Deficiency> of			
Revenues over Expenses	\$ 41,760	\$ 27,779	\$ 69,539
Decreased Assessments Receivable	3,063		3,063
Decreased Bad Debt Allowance	(4,787)		(4,787)
Increased Prepaid Taxes	(115)		(115)
Decreased Accounts Payable	(2,015)		(2,015)
Increased Prepaid Assessments	7,323		7,323
Decreased Taxes Payable	(208)		(208)
Increased Other Liability	325		325
Net Increase <Decrease> in Operating Cash	<u>\$ 45,346</u>	<u>\$ 27,779</u>	<u>\$ 73,126</u>

The Mediterranean Villas Homeowners Association
Notes to the Financial Statements
December 31, 2013

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 build out. At full build out there should be 229 units. As of December 31, 2013 there were 216 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. There is no allowance necessary at the end of the fiscal year.

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, 2013

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.

There were significant changes between the Required Supplemental Information presented in the prior audit and in the current audit. The Association had an updated reserve study prepared and it was determined that reserve component asset remaining lives and replacement costs required revision. The most significant change was removing the replacement of gas vents on the building roofs from the component list, as these have been determined to be the responsibility of the home owners. These changes have been 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 \$100.00. 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.

The Mediterranean Villas Homeowners Association
December 31, 2013
Supplementary Information on Future Major Repairs
and Replacements
(Unaudited)

A level 3 reserve study without field inspection was prepared on August 16, 2013 by J2 Building Consultants, Inc. beginning July 1, 2013 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 2.5% and interest of 0.33%, 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.

<u>Component</u>	<u>Estimated Remaining Useful Life in Years</u>	<u>Estimated Current Replacement Costs</u>	<u>Fund Balance at Year End</u>
Amenities			
Signage - Repair/Renew Allowance	2	\$ 2,500	
Exterior Lighting Replacement Allowance	5	2,000	
Palazzo Interior Paint	2	2,500	
Palazzo Heat Pump Replacement	12	3,600	
Palazzo Appliance Replacement	9	1,300	
Replace Palazzo Light Fixtures and Fans - Allowance	7	800	
Palazzo Kitchen and Bath Refurbish	17	3,500	
Palazzo Window Glazing Replacement Allowance	12	1,500	
Mail Box Replacement Allowance 1	12	3,000	
Mail Box Replacement Allowance 2	22	3,000	
Hot Water Tank Replacement - Palazzo	3	500	
RV Storage Repair Allowance - Gate/Grading	2	1,500	
Roads and Curbs			
Emulsion Coat and Strip Parking Areas	1	4,350	
Curb Replacement Allowance 1	11	2,000	
Curb Replacement Allowance 2	19	2,000	
Curb Replacement Allowance 3	27	2,000	
Grounds			
Plant Replacement/Trimming	4	12,500	
Irrigation Repairs - Valves/Timers	6	13,000	
Fencing Repair Allowance	1	1,500	
Replacement of Wood Fencing	17	56,000	
Partition Patio Wall Repairs			
Allowance for Repairs 111 Total Walls	2	8,000	
Exterior Painting			
Phase 1 Ext Wall Painting - Siliconized Permeable Coating	13	199,440	
Phase 2 Ext Wall Painting - Siliconized Permeable Coating	18	199,440	
Phase 3 Ext Wall Painting - Siliconized Permeable Coating	23	199,440	
1/3 of Complex Trim Repainted Allowance	1	15,875	
Second 1/3 of Trim Paint	3	15,875	
Third 1/3 of Trim Paint	5	15,875	
Roof Covering			
Replace Palazzo and Pavilion Roofs Only	19	7,225	
TOTAL			\$ <u>285,222</u>

Percent Funded as of July 1, 2013 - 113%