

The Mediterranean Villas Homeowners Association

Audit Report Financial Statements & Supplementary Information December 31, 2016

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, 2016, 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, 2016, 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

March 22, 2017

The Mediterranean Villas Homeowners Association

Balance Sheet
December 31, 2016

	<u>OPERATING FUND</u>	<u>REPLACEMENT FUND</u>	<u>TOTAL</u>
ASSETS			
Cash, including interest bearing deposits	\$ 248,527	\$ 158,581	\$ 407,108
Investments		248,633	248,633
Assessments Receivable	9,442		9,442
Less: Allowance for Bad Debts	(5,951)		(5,951)
Prepaid Insurance	679		679
Prepaid Expense	23		23
TOTAL ASSETS	<u>\$ 252,720</u>	<u>\$ 407,214</u>	<u>\$ 659,934</u>
 LIABILITIES AND FUND BALANCES			
LIABILITIES			
Accounts Payable	\$ 11,572		\$ 11,572
Assessments Received in Advance	22,470		22,470
Income Taxes Payable	<u>2,282</u>		<u>2,282</u>
TOTAL LIABILITIES	<u>36,325</u>		<u>36,325</u>
 FUND BALANCES			
Operating	216,396		216,396
Replacement		<u>\$ 407,214</u>	<u>407,214</u>
TOTAL FUND BALANCES	<u>216,396</u>	<u>407,214</u>	<u>623,610</u>
TOTAL LIABILITIES AND FUND BALANCES	<u>\$ 252,720</u>	<u>\$ 407,214</u>	<u>\$ 659,934</u>

See Notes to the Financial Statements

The Mediterranean Villas Homeowners Association

Statement of Changes in Fund Balances

For the Year Ended December 31, 2016

	OPERATING FUND	REPLACEMENT FUND	TOTAL
Balance at the Beginning of the Year	\$ 197,900	\$ 352,573	\$ 550,474
Transfer Between Funds	(20,000)	20,000	
Excess <Deficiency> of Revenues over Expenses	<u>38,495</u>	<u>34,641</u>	<u>73,136</u>
Balance at the End of the Year	<u>\$ 216,396</u>	<u>\$ 407,214</u>	<u>\$ 623,610</u>

See Notes to the Financial Statements

The Mediterranean Villas Homeowners Association

Statement of Revenues and Expenses
For the Year Ended December 31, 2016

	OPERATING FUND	REPLACEMENT FUND	TOTAL
REVENUES			
Assessments	\$ 239,975	\$ 32,000	\$ 271,975
Initial Contributions	500		500
RV Storage	7,366		7,366
Fines	1,010		1,010
Late & NSF Fees	1,927		1,927
Interest	99	2,641	2,740
Miscellaneous	475		475
TOTAL REVENUES	<u>251,352</u>	<u>34,641</u>	<u>285,992</u>
EXPENSES			
Audit & Tax Preparation	2,400		2,400
Bookkeeping Fees	14,640		14,640
Electricity	1,659		1,659
Federal Taxes	2,580		2,580
Insurance	8,462		8,462
Landscape	126,339		126,339
Legal	2,427		2,427
Miscellaneous	725		725
Postage & Copies	1,992		1,992
Professional Fees	1,400		1,400
Real Property Taxes	885		885
Repairs & Maintenance	15,126		15,126
Resident Activities	860		860
Seasonal Decorations	977		977
Water & Sewer	32,384		32,384
TOTAL EXPENSES	<u>212,856</u>		<u>212,856</u>
EXCESS <DEFICIENCY> OF REVENUES OVER EXPENSES	<u>\$ 38,495</u>	<u>\$ 34,641</u>	<u>\$ 73,136</u>

See Notes to the Financial Statements

The Mediterranean Villas Homeowners Association
Statement of Cash Flows
For the Year Ended December 31, 2016

	OPERATING FUND	REPLACEMENT FUND	TOTAL
<i>Cash Flows from Operating Activities:</i>			
Cash from Assessments	\$ 245,752	\$ 32,000	\$ 277,752
Cash from Special Assessments	500		500
Interest Received	99	2,641	2,740
Miscellaneous Income	10,778		10,778
Income Taxes Paid	(303)		(303)
Cash Paid for Services and Products	(207,944)		(207,944)
Net Increase <Decrease> in Cash from Operating Activities	48,882	34,641	83,523
<i>Cash Flows from Investing Activities:</i>			
Purchase of Investments		(2,227)	(2,227)
Classification of Investment		(246,406)	(246,406)
<i>Cash Flows from Financing Activities:</i>			
Transfers Between Funds	(20,000)	20,000	
Net Increase <Decrease> in Cash	28,882	(193,993)	(165,110)
Cash, including interest bearing deposits, at the Beginning of Year	219,646	352,573	572,219
Cash, including interest bearing deposits, at the End of Year	<u>\$ 248,527</u>	<u>\$ 158,581</u>	<u>\$ 407,108</u>

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

Excess <Deficiency> of			
Revenues over Expenses	\$ 38,495	\$ 34,641	\$ 73,136
Decreased Assessments Receivable	914		914
Decreased Prepaid Taxes	138		138
Increased Prepaid Expenses	(23)		(23)
Increased Accounts Payable	2,212		2,212
Increased Prepaid Assessments	4,863		4,863
Increased Taxes Payable	2,282		2,282
Net Increase <Decrease> in Operating Cash	<u>\$ 48,882</u>	<u>\$ 34,641</u>	<u>\$ 83,523</u>

See Notes to the Financial Statements

The Mediterranean Villas Homeowners Association

Notes to the Financial Statements
December 31, 2016

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 228-unit planned residential development located in Pasco, Washington.

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.

Fair Value Measurements

The three levels of the fair value hierarchy under ASC 820, Fair Value Measurements and Disclosures, are described below:

Level 1: Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Association has the ability to access.

Level 2: Inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in inactive markets; inputs other than quoted prices that are observable for the asset or liability; inputs that are derived principally from or corroborated by observable market data by correlation or other means. If the asset or liability has a specified (contractual) term, the Level 2 input must be observable for substantially the full term of the asset or liability.

Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

Investments

Investments include certificates of deposit with original maturities over 90 days. These are level one type investments.

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 issued or available to be issued.

The Mediterranean Villas Homeowners Association

Notes to the Financial Statements
December 31, 2016

NOTE 2 - REPLACEMENT FUNDING PROGRAM

The Association is currently funding 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 Supplementary Information presented in the prior audit and in the current audit. The Association changed reserve preparers and it was determined that reserve component asset remaining lives and replacement costs required revision. Two of the most significant changes were: 1) adding asphalt overlay and repairs to the funding plan, and 2) a significant increase in replacement cost of painting the units' exterior walls. These changes have been approved by the Board of Directors.

Additionally, the prior year Required Supplementary Information was based upon current estimated replacement costs of the components. In the current year, future costs are presented in the Required Supplementary Information. Either disclosure is allowed; however, the reader should be aware of the difference when comparing the two reports.

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. 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 - RELATED PARTY TRANSACTIONS

A homeowner, who is the spouse of a current Board member, provides grounds keeping services for the Association. In 2016, \$6,000 was paid for the homeowner's services.

The Mediterranean Villas Homeowners Association

December 31, 2016
Supplementary Information on Future Major Repairs
and Replacements
(Unaudited)

A reserve study without inspection was prepared on August 29, 2016 by Reserve Studies by Reserve Funding for the period January 1, 2017 to December 31, 2017 to estimate the remaining useful lives and the replacement costs of the components of common property. The estimates were based on future estimated replacement costs. Funding requirements consider an annual inflation rate of 2.05% and interest of 0.53%, 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 in Years	Estimated Future Replacement Costs	Fund Balance at Year End
Appliances			
Palazzo - Replace	5	\$ 1,466	
Asphalt			
Overlay	11	48,941	
Repairs	4	6,290	
Sealcoat - Striping	4	5,976	
Building Structure			
Maintenance Shed: Replacement	16	4,843	
Curbs			
Replace - 1	7	1,174	
Replace - 2	15	1,381	
Replace - 3	15	1,381	
Replace - 4	16	1,410	
Replace - 5	17	1,439	
Replace - 6	18	1,468	
Doors			
Doors and Windows: Palazzo	6	8,302	
Drainage			
Storm Drains: Renovation	16	10,377	
Fencing Repair Allowance			
Repairs	0	1,546	
Replace	13	100,660	
Grounds Components			
Benches/Tables Concrete - Common	11	2,781	
Doggie Cleanup Stations: Replace	1	765	
Heating			
HVAC Wall Unit: Palazzo - Replace	8	4,705	
Landscaping			
Irrigation - Repairs	2	14,320	
Renovation - Replace	2	13,538	
Trees - Prune, Trim	7	5,763	
Lighting			
Exterior - Replace	1	2,296	
Palazzo - Interior Fixtures	3	903	
Mailboxes			
Replace - A	6	11,860	
Replace - B	8	11,939	
Monument			
Replace	11	17,501	
Painting			
Exterior - Phase 1	9	265,512	
Exterior - Phase 2	14	324,843	
Exterior - Phase 3	15	244,680	
Exterior - Phase 4	16	346,353	
Exterior - Phase 5	17	337,014	
Exterior - Phase 6	22	300,222	
Exterior - Trim - Phase 1	0	9,029	
Exterior - Trim - Phase 2	0	9,979	
Exterior - Trim - Phase 3	0	7,366	
Exterior - Trim - Phase 4	1	10,426	

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The Mediterranean Villas Homeowners Association

December 31, 2016

Supplementary Information on Future Major Repairs
and Replacements
(Unaudited)

Component	Estimated Remaining Useful Life in Years	Estimated Future Replacement Costs	Fund Balance at Year End
Painting - CONT.			
Exterior - Trim - Phase 5	2	\$ 10,145	
Exterior - Trim - Phase 6	3	8,333	
Palazzo - Interior	1	2,959	
Palazzo - Pavilion - Exterior	0	3,289	
Palazzo - Pavilion - Trim	0	658	
Power Supply			
Utilities: Power Supply	31	13,131	
Refurbishing			
Kitchen & Restrooms: Palazzo	13	4,882	
Roofing			
Palazzo - Pavilion - Replace	10	12,182	
RV Storage			
Gate - Chain Link	6	3,750	
Grading - Gravel	4	4,501	
Signs			
Replace	2	2,864	
Utilities			
Water Supply	26	14,406	
Walls			
Partition - Repairs	2	13,411	
Water Heater			
Palazzo - Kitchen	1	633	
Palazzo - Restroom	1	490	
Waste Product Lines			
Utilities	21	13,782	
TOTAL			\$ <u><u>407,214</u></u>

Percent Funded as of January 1, 2017 - 63.0%