

The Mediterranean Villas Homeowners Association

Audit Report Financial Statements & Supplementary Information December 31, 2017

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, 2017, 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, 2017, 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

April 18, 2018

The Mediterranean Villas Homeowners Association

Balance Sheet
December 31, 2017

	<u>OPERATING FUND</u>		<u>REPLACEMENT FUND</u>		<u>TOTAL</u>
ASSETS					
Cash, including interest bearing deposits	\$ 291,319	\$	211,670	\$	502,990
Investments			250,934		250,934
Assessments Receivable	611				611
Prepaid Insurance	679				679
Prepaid Income Taxes	152				152
Prepaid Expense	23				23
TOTAL ASSETS	<u>\$ 292,784</u>	\$	<u>462,604</u>	\$	<u>755,388</u>
 LIABILITIES AND FUND BALANCES					
LIABILITIES					
Accounts Payable	\$ 8,532			\$	8,532
Assessments Received in Advance	33,000				33,000
TOTAL LIABILITIES	<u>41,532</u>				<u>41,532</u>
 FUND BALANCES					
Operating	251,252				251,252
Replacement		\$	462,604		462,604
TOTAL FUND BALANCES	<u>251,252</u>		<u>462,604</u>		<u>713,856</u>
TOTAL LIABILITIES AND FUND BALANCES	<u>\$ 292,784</u>	\$	<u>462,604</u>	\$	<u>755,388</u>

See Notes to the Financial Statements

The Mediterranean Villas Homeowners Association

Statement of Changes in Fund Balances
For the Year Ended December 31, 2017

	OPERATING FUND	REPLACEMENT FUND	TOTAL
Balance at the Beginning of the Year	\$ 216,396	\$ 407,214	\$ 623,610
Excess <Deficiency> of Revenues over Expenses	<u>34,856</u>	<u>55,390</u>	<u>90,246</u>
Balance at the End of the Year	<u>\$ 251,252</u>	<u>\$ 462,604</u>	<u>\$ 713,856</u>

See Notes to the Financial Statements

The Mediterranean Villas Homeowners Association

Statement of Revenues and Expenses
For the Year Ended December 31, 2017

	OPERATING FUND	REPLACEMENT FUND	TOTAL
REVENUES			
Assessments	\$ 248,470	\$ 52,500	\$ 300,970
RV Storage	6,688		6,688
Insurance Claim	4,989		4,989
Interest	299	2,890	3,189
Bad Debt Recovery	5,951		5,951
Miscellaneous	704		704
TOTAL REVENUES	267,101	55,390	322,491
EXPENSES			
Audit & Tax Preparation	2,400		2,400
Bookkeeping Fees	14,880		14,880
Electricity	1,537		1,537
Federal Taxes	2,448		2,448
Insurance	8,842		8,842
Insurance Claim	6,342		6,342
Landscape	131,258		131,258
Miscellaneous	2,457		2,457
Postage & Copies	1,380		1,380
Professional Fees	1,400		1,400
Repairs & Maintenance	30,025		30,025
RV Storage	1,416		1,416
Water & Sewer	27,859		27,859
TOTAL EXPENSES	232,245		232,245
EXCESS <DEFICIENCY> OF REVENUES OVER EXPENSES	\$ 34,856	\$ 55,390	\$ 90,246

See Notes to the Financial Statements

The Mediterranean Villas Homeowners Association

Statement of Cash Flows
For the Year Ended December 31, 2017

	OPERATING FUND	REPLACEMENT FUND	TOTAL
<i>Cash Flows from Operating Activities:</i>			
Cash from Assessments	\$ 267,831	\$ 52,500	\$ 320,331
Interest Received	299	2,890	3,189
Miscellaneous Income	18,332		18,332
Income Taxes Paid	(4,882)		(4,882)
Cash Paid for Services and Products	(238,789)		(238,789)
Net Increase <Decrease> in Cash from Operating Activities	42,792	55,390	98,182
<i>Cash Flows from Investing Activities:</i>			
Purchase of Investments		(2,300)	(2,300)
Net Increase <Decrease> in Cash	42,792	53,090	95,881
Cash, including interest bearing deposits, at the Beginning of Year	248,527	158,581	407,108
Cash, including interest bearing deposits, at the End of Year	<u>\$ 291,319</u>	<u>\$ 211,670</u>	<u>\$ 502,990</u>

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

Excess <Deficiency> of			
Revenues over Expenses	\$ 34,856	\$ 55,390	\$ 90,246
Decreased Assessments Receivable	8,832		8,832
Decreased Bad Debt Allowance	(5,951)		(5,951)
Increased Prepaid Taxes	(152)		(152)
Decreased Accounts Payable	(3,041)		(3,041)
Increased Prepaid Assessments	10,530		10,530
Decreased Taxes Payable	(2,282)		(2,282)
Net Increase <Decrease> in Operating Cash	<u>\$ 42,792</u>	<u>\$ 55,390</u>	<u>\$ 98,182</u>

See Notes to the Financial Statements

The Mediterranean Villas Homeowners Association

Notes to the Financial Statements
December 31, 2017

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, which approximates the net realizable value. 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.

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, 2017

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.

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 \$110. 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 2017, \$6,000 was paid for the homeowner's services.

NOTE 6 - UNINSURED CASH BALANCES

The Association's cash deposits are with various financial institutions. 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 FDIC limitation by over \$46,000.

The Mediterranean Villas Homeowners Association

December 31, 2017
Supplementary Information on Future Major Repairs
and Replacements
(Unaudited)

A level III updated on-site reserve study with funding analysis and plan was prepared on July 29, 2017 by Reserve Studies by Reserve Funding for the period January 1, 2018 to December 31, 2018 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 2.22% 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	4	\$ 1,447	
Asphalt			
Overlay	10	48,763	
Repairs	3	6,195	
Sealcoat - Striping	3	5,885	
Building Structure			
Maintenance Shed: Replacement	15	4,865	
Curbs			
Replace - 1	6	1,162	
Replace - 2	14	1,386	
Replace - 3	14	1,386	
Replace - 4	15	1,416	
Replace - 5	16	1,448	
Replace - 6	17	1,480	
Doors			
Doors and Windows: Palazzo	5	8,203	
Drainage			
Storm Drains: Renovation	15	10,426	
Fencing Repair Allowance			
Repairs	0	1,546	
Replace	12	100,628	
Grounds Components			
Benches/Tables Concrete - Common	10	2,771	
Doggie Cleanup Stations: Replace	0	750	
Heating			
HVAC Wall Unit: Palazzo - Replace	7	4,665	
Landscaping			
Irrigation - Repairs	1	14,055	
Renovation - Replace	1	13,289	
Trees - Prune, Trim	6	5,704	
Lighting			
Exterior - Replace	0	2,250	
Palazzo - Interior Fixtures	2	888	
Mailboxes			
Replace - A	5	11,718	
Replace - B	7	11,836	
Monument			
Replace	10	17,438	
Painting			
Exterior - Phase 1	8	263,665	
Exterior - Phase 2	13	325,281	
Exterior - Phase 3	14	245,418	
Exterior - Phase 4	15	347,976	
Exterior - Phase 5	16	339,157	
Exterior - Phase 6	21	304,656	
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	0	10,217	

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The Mediterranean Villas Homeowners Association

December 31, 2017

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	1	\$ 9,958	
Exterior - Trim - Phase 6	2	8,193	
Palazzo - Interior	0	2,900	
Palazzo - Pavilion - Exterior	0	3,289	
Palazzo - Pavilion - Trim	0	658	
Power Supply			
Utilities: Power Supply	30	13,526	
Refurbishing			
Kitchen & Restrooms: Palazzo	12	4,880	
Roofing			
Palazzo - Pavilion - Replace	9	12,118	
RV Storage			
Gate - Chain Link	5	3,705	
Grading - Gravel	3	4,433	
Signs			
Replace	1	2,811	
Utilities			
Water Supply	25	14,717	
Walls			
Partition - Repairs	1	13,163	
Water Heater			
Palazzo - Kitchen	0	620	
Palazzo - Restroom	0	480	
Waste Product Lines			
Utilities	20	13,962	
 TOTAL			 \$ <u>462,604</u>

Percent Funded as of January 1, 2018 - 67.0%