

The Mediterranean Villas Homeowners Association

Audit Report Financial Statements & Supplementary Information December 31, 2015

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, 2015, 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, 2015, 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 5, 2016

The Mediterranean Villas Homeowners Association

Balance Sheet
December 31, 2015

	<u>OPERATING FUND</u>	<u>REPLACEMENT FUND</u>	<u>TOTAL</u>
ASSETS			
Cash, including interest bearing deposits	\$ 219,646	\$ 352,573	\$ 572,219
Assessments Receivable	10,356		10,356
Less: Allowance for Bad Debts	(5,951)		(5,951)
Prepaid Insurance	679		679
Prepaid Income Taxes	138		138
TOTAL ASSETS	<u>\$ 224,868</u>	<u>\$ 352,573</u>	<u>\$ 577,441</u>
 LIABILITIES AND FUND BALANCES			
LIABILITIES			
Accounts Payable	\$ 9,360		\$ 9,360
Assessments Received in Advance	17,608		17,608
TOTAL LIABILITIES	<u>26,968</u>		<u>26,968</u>
 FUND BALANCES			
Operating	197,900		197,900
Replacement		352,573	352,573
TOTAL FUND BALANCES	<u>197,900</u>	<u>352,573</u>	<u>550,474</u>
TOTAL LIABILITIES AND FUND BALANCES	<u>\$ 224,868</u>	<u>\$ 352,573</u>	<u>\$ 577,441</u>

See Notes to the Financial Statements

The Mediterranean Villas Homeowners Association

Statement of Changes in Fund Balances

For the Year Ended December 31, 2015

	OPERATING FUND	REPLACEMENT FUND	TOTAL
Balance at the Beginning of the Year	\$ 205,205	\$ 318,748	\$ 523,953
Excess <Deficiency> of Revenues over Expenses	<u>(7,305)</u>	<u>33,825</u>	<u>26,520</u>
Balance at the End of the Year	<u>\$ 197,900</u>	<u>\$ 352,573</u>	<u>\$ 550,474</u>

See Notes to the Financial Statements

The Mediterranean Villas Homeowners Association
Statement of Revenues and Expenses
For the Year Ended December 31, 2015

	OPERATING FUND	REPLACEMENT FUND	TOTAL
REVENUES			
Assessments	\$ 234,550	\$ 32,000	\$ 266,550
RV/Storage	6,990		6,990
Late & NSF Fees	2,182		2,182
Interest	368	1,825	2,193
Miscellaneous	1,332		1,332
TOTAL REVENUES	<u>245,422</u>	<u>33,825</u>	<u>279,248</u>
EXPENSES			
Audit & Tax Preparation	2,400		2,400
Bad Debts	2,541		2,541
Bookkeeping Fees	13,500		13,500
Electricity	1,620		1,620
Federal Taxes	502		502
Insurance	8,614		8,614
Landscape	117,990		117,990
Legal	630		630
Major Repairs & Maint.	47,217		47,217
Miscellaneous	157		157
Office Supplies	872		872
Postage & Copies	633		633
Real Property Taxes	882		882
Repairs & Maintenance	20,916		20,916
Resident Activities	976		976
Seasonal Decorations	956		956
Water & Sewer	32,321		32,321
TOTAL EXPENSES	<u>252,727</u>		<u>252,727</u>
EXCESS <DEFICIENCY> OF REVENUES OVER EXPENSES	<u>\$ (7,305)</u>	<u>\$ 33,825</u>	<u>\$ 26,520</u>

See Notes to the Financial Statements

The Mediterranean Villas Homeowners Association

Statement of Cash Flows
For the Year Ended December 31, 2015

	OPERATING FUND	REPLACEMENT FUND	TOTAL
<i>Cash Flows from Operating Activities:</i>			
Cash from Assessments	\$ 225,772	\$ 32,000	\$ 257,772
Interest Received	368	1,825	2,193
Miscellaneous Income	10,504		10,504
Income Taxes Paid	(1,058)		(1,058)
Cash Paid for Services and Products	(244,691)		(244,691)
Net Increase <Decrease> in Cash from Operating Activities	(9,105)	33,825	24,721
Net Increase <Decrease> in Cash	(9,105)	33,825	24,721
Cash, including interest bearing deposits, at the Beginning of Year	228,750	318,748	547,498
Cash, including interest bearing deposits, at the End of Year	\$ 219,646	\$ 352,573	\$ 572,219

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

Excess <Deficiency> of Revenues over Expenses	\$ (7,305)	\$ 33,825	\$ 26,520
Increased Assessments Receivable	(3,746)		(3,746)
Increased Bad Debt Allowance	2,386		2,386
Increased Prepaid Taxes	(138)		(138)
Decreased Other Receivable	4,080		4,080
Increased Accounts Payable	1,068		1,068
Decreased Prepaid Assessments	(5,032)		(5,032)
Decreased Taxes Payable	(418)		(418)
Net Increase <Decrease> in Operating Cash	\$ (9,105)	\$ 33,825	\$ 24,721

The Mediterranean Villas Homeowners Association

Notes to the Financial Statements
December 31, 2015

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 228 units. As of December 31, 2015 there were 223 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.

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.

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, 2015

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. 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, 2015
 Supplementary Information on Future Major Repairs
 and Replacements
 (Unaudited)

A level 3 reserve study without inspection was prepared on September 29, 2014 by J2 Building Consultants, Inc. beginning August 1, 2014 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 2.00% 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 Current Replacement Costs	Fund Balance at Year End
Amenities			
Signage - Repair/Renew Allowance	8	\$ 2,550	
Exterior Lighting Replacement Allowance	10	2,050	
Palazzo Interior Paint	10	2,700	
Palazzo Heat Pump Replacement	20	3,675	
Palazzo Appliance Replacement	15	1,325	
Replace Palazzo Light Fixtures and Fans - Allowance	15	825	
Palazzo Kitchen and Bath Refurbish	25	3,575	
Palazzo Window Glazing Replacement Allowance	20	1,550	
Mail Box Replacement Allowance 1	20	3,050	
Mail Box Replacement Allowance 2	30	1,050	
Hot Water Tank Replacement - Palazzo	10	600	
RV Storage Repair Allowance - Gate/Grading	6	1,550	
Roads and Curbs			
Emulsion Coat and Strip Parking Areas	7	5,510	
Curb Replacement Allowance 1	20	2,050	
Curb Replacement Allowance 2	20	2,050	
Curb Replacement Allowance 3	28	2,050	
Grounds			
Plant Replacement/Trimming	5	12,750	
Irrigation Repairs - Valves/Timers	7	13,250	
Fencing Repair Allowance	3	1,550	
Replacement of Wood Fencing	25	58,800	
Partition Patio Wall Repairs			
Allowance for Repairs 111 Total Walls	4	8,500	
Exterior Painting			
Phase 1 Ext Wall Painting - Siliconized Permeable Coating	20	210,520	
Phase 2 Ext Wall Painting - Siliconized Permeable Coating	20	210,520	
Phase 3 Ext Wall Painting - Siliconized Permeable Coating	24	210,520	
1/3 of Complex Trim Repainted Allowance	6	17,145	
Second 1/3 of Trim Paint	6	17,145	
Third 1/3 of Trim Paint	6	17,145	
Roof Covering			
Replace Palazzo and Pavilion Roofs Only	30	7,650	
TOTAL			\$ <u><u>352,573</u></u>

Percent Funded as of August 1, 2014 - 142%