

THE SOUTH BAY COMMUNITY ASSOCIATION

INDEPENDENT AUDITOR'S REPORT

AND

AUDITED FINANCIAL STATEMENTS

FOR THE

YEAR ENDED JUNE 30, 2017

AND

UNAUDITED SUPPLEMENTARY INFORMATION

THE SOUTH BAY COMMUNITY ASSOCIATION

TABLE OF CONTENTS

	Page
INDEPENDENT AUDITOR'S REPORT.....	1-2
FINANCIAL STATEMENTS	
Balance Sheet.....	3
Statement of Revenues, Expenses and Changes in Fund Balance	4
Statement of Cash Flows.....	5
Notes to Financial Statements	6-10
UNAUDITED SUPPLEMENTARY INFORMATION	
Unaudited Supplementary Information on Future Major Repairs and Replacements.....	10-12

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors and Members
The South Bay Community Association

We have audited the accompanying financial statements of The South Bay Community Association, which comprise the balance sheet as of June 30, 2017, and the related statements of revenues, expenses, and changes in fund balance and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management 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 from 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.

INDEPENDENT AUDITOR'S REPORT--Continued

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

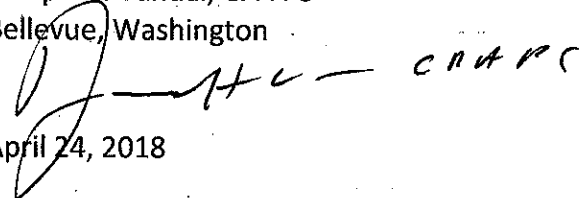
Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The South Bay Community Association as of June 30, 2017, and the results of its operations and its cash flows for year then ended in conformity with accounting principles generally accepted in the United States of America.

Disclaimer of Opinion on Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the information on future major repairs and replacements on common property on pages 11-12 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 for placing basic financial statements 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.

Joseph H. Vandal, CPA PS.
Bellevue, Washington

 CHARRC
April 24, 2018

THE SOUTH BAY COMMUNITY ASSOCIATION
BALANCE SHEET
June 30, 2017

	OPERATING FUND	REPLACEMENT RESERVE FUND	TOTAL
<u>ASSETS</u>			
Cash-Checking	\$ 24,858	\$ -	\$ 24,858
Cash-Replacement Reserve	-	169,231	169,231
Cash-Petty Cash	500	-	500
Certificates of Deposit	-	126,238	126,238
Assessments Receivable	-	248,358	248,358
Prepaid Insurance	5,111	-	5,111
Loan Fees	-	8,160	8,160
Accumulated Amortization	-	(1,632)	(1,632)
Equipment	-	41,047	41,047
Accumulated Depreciation	-	(39,258)	(39,258)
Total Assets	<u>\$ 30,469</u>	<u>\$ 552,144</u>	<u>\$ 582,613</u>
<u>LIABILITIES AND FUND BALANCE</u>			
Accounts Payable	\$ 2,090	\$ -	\$ 2,090
Payroll Liabilities	6,866	-	6,866
Loan Payable	-	306,012	306,012
Prepaid Assessments	16,334	-	16,334
Total Liabilities	25,290	306,012	331,302
Fund Balance	<u>5,179</u>	<u>246,132</u>	<u>251,311</u>
Total Liabilities & Fund Balance	<u>\$ 30,469</u>	<u>\$ 552,144</u>	<u>\$ 582,613</u>

THE SOUTH BAY COMMUNITY ASSOCIATION
STATEMENT OF REVENUES, EXPENSES AND CHANGE IN FUND BALANCE
For the Year Ended June 30, 2017

	OPERATING FUND	REPLACEMENT RESERVE FUND	TOTAL
REVENUES			
Assessments			
Regular	\$ 403,686	\$ 73,260	\$ 476,946
Bad Debt Recovery	6,280	-	6,280
Other	32,917	-	32,917
Interest	96	3,067	3,163
TOTAL REVENUE	442,979	76,327	519,306
EXPENSES			
Administration	35,277	-	35,277
Professional Services	10,125	-	10,125
Licenses and Permits	900	-	900
Payroll Expense	223,749	-	223,749
Property Tax	18	-	18
Insurance	16,417	-	16,417
Bad Debt	76	-	76
Repairs and Maintenance	45,088	-	45,088
Grounds and Landscape	25,089	-	25,089
Utilities	67,847	-	67,847
Depreciation	-	3,950	3,950
Amortization	-	1,632	1,632
Reserve Study	-	3,910	3,910
Interest Expense	-	16,930	16,930
Major Repairs and Replacements	-	858,078	858,078
TOTAL EXPENSES	424,586	884,500	1,309,086
REVENUES OVER/(UNDER) EXPENSES	18,393	(808,173)	(789,780)
BEGINNING FUND BALANCE	404,922	617,454	1,022,376
Capital Contribution	-	18,715	18,715
Transfer to (from)	(418,136)	418,136	-
ENDING BALANCE	\$ 5,179	\$ 246,132	\$ 251,311

THE SOUTH BAY COMMUNITY ASSOCIATION
STATEMENT OF CASH FLOWS
For the Year Ended June 30, 2017

	OPERATING FUND	REPLACEMENT RESERVE FUND	TOTAL
<u>CASH FLOWS FROM OPERATING</u>			
<u>ACTIVITIES</u>			
REVENUE OVER/(UNDER) EXPENSES	\$ 18,393	\$ (808,173)	\$ (789,780)
Adjustments to reconcile excess of expenses over revenues to net cash provided by activities:			
Depreciation & Amortization	22,073	(8,317)	13,756
(Increase) Decrease in:			
Assessments Receivable	395,150	(248,358)	146,792
Prepaid Insurance	(3,210)	-	(3,210)
Increase (Decrease) in:			
Accounts Payable	(7,289)	-	(7,289)
Payroll Liabilities	(16,500)	-	(16,500)
Prepaid Assessments	(8,706)	-	(8,706)
<u>NET CASH PROVIDED BY</u>			
<u>OPERATING ACTIVITIES</u>	<u>399,911</u>	<u>(1,064,848)</u>	<u>(664,937)</u>
<u>CASH FLOWS FROM</u>			
<u>FINANCING ACTIVITIES</u>			
Note Payable	-	306,012	306,012
Capital Contribution	-	18,715	18,715
Interfund transfers	(418,136)	418,136	-
<u>NET CASH (USED) PROVIDED</u>			
<u>BY FINANCING ACTIVITIES</u>	<u>(418,136)</u>	<u>742,863</u>	<u>324,727</u>
NET INCREASE (DECREASE)			
IN CASH & EQUIVALENTS	(18,225)	(321,985)	(340,210)
CASH & EQUIVALENTS AT			
BEGINNING OF THE PERIOD	<u>43,583</u>	<u>617,454</u>	<u>661,037</u>
CASH & EQUIVALENTS AT			
END OF THE PERIOD	<u>\$ 25,358</u>	<u>\$ 295,469</u>	<u>\$ 320,827</u>
<u>SUPPLEMENTAL DISCLOSURE</u>			
Interest Expense	<u>\$ -</u>	<u>\$ 16,930</u>	<u>\$ 16,930</u>

THE SOUTH BAY COMMUNITY ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
June 30, 2017

NOTE A – NATURE OF ORGANIZATION

The South Bay Community Association is a statutory homeowner Association in the State of Washington organized and incorporated in 1989. The Association is responsible for the operation and maintenance of the common property of The South Bay Community Association. The South Bay Community Association consists of 600 residential units or lots located in Port Ludlow, Washington.

NOTE B – DATE OF MANAGEMENT'S REVIEW

In preparing the financial statements, the Association has evaluated events and transactions for potential recognition or disclosure through April 24, 2018, the date that the financial statements were available to be issued.

NOTE C-SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Fund Accounting

The Association's governing documents provide certain guidelines for governing its financial activities. To ensure observance of limitations and restrictions on the use of financial resources, the Association maintains its accounts using fund accounting. Financial resources are classified for accounting and reporting purposes in the following funds established according to their nature and purpose:

Operating Fund-This fund is used to account for the financial resources available for the general operations of the Association.

Replacement Fund-This fund (Reserve Fund) is used to accumulate financial resources designated for future major repairs and replacements.

Cash and Cash Equivalents

The Association considers cash on deposit, cash on hand, money market funds (if any) and certificates of deposit (if any) and any other highly-liquid securities to be cash and or cash equivalents. Any penalties for early withdrawal would not have a material effect on the financial statements.

THE SOUTH BAY COMMUNITY ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
June 30, 2017

NOTE C-SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES-CONTINUED

Member Assessments

Association members are subject to annual assessments billed quarterly 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 policy is to place liens on the properties of homeowners whose assessments are delinquent. Any excess assessments at year end are retained by the Association for use in the succeeding year. If assessments are inadequate, the Board of Directors, subject to the limitations of their authority described in the Association's governing documents, may have to increase regular assessments or pass special assessments.

Property and Equipment

Real property and common areas acquired from the developer and related improvements to such property are not recorded in the Association's financial statements because they cannot be sold at the discretion of the Board of Directors or produce significant cash flows from non-members. The Association capitalizes personal property at cost and depreciates it using the straight-line method.

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.

NOTE D-COMMITMENTS

The Association has various contracts for services including but not limited to management, maintenance, and landscaping.

THE SOUTH BAY COMMUNITY ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
June 30, 2017

NOTE E-INCOME TAXES

Homeowner Associations may be taxed either as homeowners' Associations or as regular corporations. In 2016, the Association elected to be taxed as a homeowners' Association. Under that election, the Association is taxed on its nonexempt function income, such as net interest earnings, at a flat rate of 30%. Exempt function income, which consists primarily of member assessments, is not taxable.

As of June 30, 2017, the tax years that remain subject to examination by taxing authorities begin with 2013.

NOTE F-FUTURE MAJOR REPAIRS AND REPLACEMENTS

The Association's accumulates funds for future major repairs and replacements. Accumulated funds (assets less liabilities as reported on the balance sheet), which in aggregate are approximately \$3,558 at June 30, 2017, are held in separate accounts and are generally not available for operating purposes. Cash balances shown on the balance sheet that are part of these funds are held in separate bank accounts.

The Association engaged a specialist who conducted a study update in 2017 to estimate the remaining useful lives and the replacement costs of the common property components. The Association is partially funding for such major repairs and replacements over the estimated lives of the components based on the study's estimates of current replacement costs, considering amounts previously accumulated in the replacement fund. Actual expenditures, however, may vary from the estimated amounts and the variations may be material. Therefore, amounts accumulated in the replacement fund may not be adequate to meet future needs. If additional funds are needed, however, the Association has the right, subject to the limitations of the authority described in the Association's governing documents, to increase regular assessments or levy special assessments, or it may delay major repairs and replacements until funds are available.

NOTE G-SPECIAL ASSESSMENT

The Association levied a special assessment in 2016 in the amount of \$600,000 for repayment of a loan that was taken out at the same time. The assessments began July 1, 2016 and was due in one lump sum or payments of \$50 per quarter over 5 years.

THE SOUTH BAY COMMUNITY ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
June 30, 2017

NOTE H-LOAN PAYABLE

The Association received a loan from Sound Community Bank in June 2016 for the amount of \$500,00 for building repairs. The loan began July 1, 2016 and is amortized over 5 years at an interest rate of 3.98% per annum. The loan is secured by a deed of trust on real property owned by the Association at 120 Spinnaker Place, Port Ludlow, WA.

Principal payments required on the notes payable for future years are summarized as follows:

Year ending June 30,

2018	\$ 100,626
2019	104,705
2020	<u>100,681</u>
	<u>\$ 306,012</u>

Interest expense related to these obligations for the period ended June 30, 2017 was \$16,930.

NOTE I-FIXED ASSETS

Fixed assets consisted of the following at June 30, 2017:

	<u>Operating</u> <u>Fund</u>
Tennis Court/Equipment	\$ 41,045
Accumulated Depreciation	<u>(39,258)</u>
	<u>\$ 1,787</u>

Current year depreciation for the year ended June 30, 2017, was \$3,950.

NOTE J-TRACTS A, B AND C OF LUDLOW POINT VILLAGE DIVISION I

A Quit Claim Deed was executed by Pope Resources and recorded to correct the scrivener's error and to clear title to the common areas known as Tracts A, B and C of Ludlow Point Village Division 1. The lots are not reported on the financial statements as described in Note C.

SUPPLEMENTARY INFORMATION

**THE SOUTH BAY COMMUNITY ASSOCIATION
UNAUDITED SUPPLEMENTARY INFORMATION ON
FUTURE MAJOR REPAIRS AND REPLACEMENTS
June 30, 2017**

A specialist conducted a study update in 2017 to estimate the remaining useful lives and the replacement costs of the components of common property. Replacement costs were based on the estimated costs to repair or replace the common property components at the date of the study. Estimated current replacement costs have not been revised since that date and do not take into account the effects of inflation between the date of the study and the date that the components will require repair or replacement.

The following information on pages 11-12 is based on the study and present significant information about the components of common property.

THE SUPPLEMENTARY INFORMATION ON FUTURE MAJOR REPAIRS AND REPLACEMENTS THAT HAS
NOT BEEN AUDITED APPEARS ON PAGES 11-12

Executive Summary

23316-1

# Component	Useful Life (yrs)	Rem. Useful Life (yrs)	Current Average Cost
Site Improvements			
120 Asphalt - Resurface	35	7	\$151,000
270 Pole Lights - Replace	40	12	\$33,000
Recreation			
402 Pool - Resurface	10	6	\$24,000
404 Pool/Spa Tile/Coping - Replace	20	6	\$16,000
410 Pool/Spa Filters - Replace	20	12	\$3,700
411 Pool/Spa Heat Pumps - Replace	15	10	\$20,000
412 Spa/Hot Tub Heater - Replace	5	0	\$3,000
414 Pool/Spa Pump Controls - Replace	10	5	\$4,200
460 Gazebo Structure - Partial Replace	10	5	\$4,000
462 Gazebo Roof - Replace	25	19	\$3,000
Bay Club Exterior			
504 Bay Club Metal Roof - Replace	40	12	\$350,000
505 Bay Club Roof - One Year Repair	0	0	\$13,200
506 Bay Club Roof - Seal	5	0	\$5,300
510 Bay Club Gutters/Downspouts-Replace	30	29	\$9,500
515 Skylights - Replace	40	12	\$18,000
540 Exterior Surfaces-Clean/Seal/Paint	10	9	\$48,000
542 Exterior Siding - Repair/Replace	40	39	\$225,000
544 Windows/SGD's - Replace	40	39	\$175,000
604 Wood Floor - Replace	36	13	\$51,000
614 Interior Lights - Replace	24	13	\$60,000
630 Kitchen - Refurbish	25	8	\$20,000
632 Dishwasher - Refurbish	20	0	\$3,500
632 Gas Oven/Range - Refurbish	15	0	\$5,000
635 Cooking/Holding Oven - Replace	20	11	\$6,000
636 Commercial Refrigerator - Replace	10	8	\$5,000
637 Electric Double Oven - Replace	15	13	\$4,000

**Current Average
Cost**

50 Total Funded Components

Note 1: Yellow highlighted line items are expected to require attention in this initial year, [REDACTED] items are expected to occur within the first five years.