

WATERWOOD IMPROVEMENT ASSOCIATION, INC.

*FINANCIAL STATEMENTS AND SUPPLEMENTARY INFORMATION*

*FOR THE YEAR ENDED DECEMBER 31, 2014*



**Davis, Heinemann & Company, P.C.**

*Certified Public Accountants*

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**INDEPENDENT AUDITOR'S REPORT**

Board of Directors  
Waterwood Improvement Association, Inc.  
Huntsville, Texas 77320

Dear Board Members:

We have audited the accompanying financial statements of the Waterwood Improvement Association, Inc. (a non-profit organization), which comprise the balance sheet as of December 31, 2014, and the related statements of revenues and expenses, changes in members' equity 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 the 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 misstatements.

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

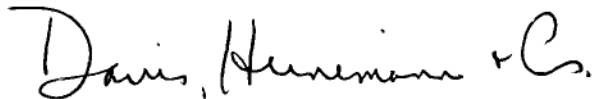
financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of 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 Waterwood Improvement Association, Inc. as of December 31, 2014, and the changes in its members' equity and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Sincerely,

A handwritten signature in cursive script that reads "Davis, Heinemann & Co." The signature is written in dark ink and is positioned above the typed name of the firm.

Davis, Heinemann & Company, P.C.  
Huntsville, Texas  
June 5, 2015

WATERWOOD IMPROVEMENT ASSOCIATION, INC.  
BALANCE SHEET  
December 31, 2014

ASSETS

Cash and cash equivalents, including interest-bearing deposits	\$	171,663
Annual charges receivable and accrued interest on delinquent receivables, less allowance for bad debts		440,436
Accrued interest receivable		104,302
Investments		7,695,263
Property and equipment, less accumulated depreciation		111,493
Other assets		297,126
<b>TOTAL ASSETS</b>	<b>\$</b>	<b><u>8,820,283</u></b>

LIABILITIES AND MEMBERS' EQUITY

Accounts payable and other accrued liabilities	\$	7,169
Capital improvement deposits		2,000
Payroll taxes payable		433
<b>Total Liabilities</b>		<b><u>9,602</u></b>
 Members' Equity		
Designated for current and future obligations		8,339,190
Accumulated other comprehensive income		471,491
<b>Total Members' Equity</b>		<b><u>8,810,681</u></b>
 <b>TOTAL LIABILITIES AND MEMBERS' EQUITY</b>	<b>\$</b>	<b><u>8,820,283</u></b>

The accompanying notes are an integral part of these financial statements.

WATERWOOD IMPROVEMENT ASSOCIATION, INC.  
STATEMENT OF REVENUES AND EXPENSES  
For the Year Ended December 31, 2014

REVENUES	
Annual charges	\$ 790,556
Interest on delinquent annual charges	116,441
Recoveries	125,076
Investment income	338,066
Capital improvement charges	1,000
Property transfer fees	2,200
Unrealized gain/(loss) on securities	403,333
Donations	3,290
Other income	3,350
Total Revenue	1,783,312
EXPENSES	
Vehicle expense	11,318
Bad debts	466,317
Repairs and maintenance - buildings	3,689
Licenses and fees	1,004
Community events	12,671
EMS contract	96,253
Insurance	30,938
Grounds maintenance contract	117,164
Miscellaneous	1,392
Office expense	18,873
Salaries and payroll tax	251,301
Professional fees	24,674
Road repair and maintenance	114,605
Taxes	8,215
Travel and meals	665
Utilities and services	74,962
Depreciation	25,797
Bond amortization	39,526
Waterwood Volunteer Fire Department	8,887
Lease payments	6,185
Collection expense	30,135
Total Expenses	1,344,571
Excess Revenues Over Expenses	\$ 438,741

The accompanying notes are an integral part of these financial statements.

WATERWOOD IMPROVEMENT ASSOCIATION, INC.  
STATEMENT OF CHANGES IN MEMBERS' EQUITY  
For the Year Ended December 31, 2014

MEMBERS' EQUITY, BEGINNING OF YEAR	\$ 8,371,940
Excess Expenses Over Revenues	<u>438,741</u>
MEMBERS' EQUITY, END OF YEAR	<u><u>\$ 8,810,681</u></u>

The accompanying notes are an integral part of these financial statements.

WATERWOOD IMPROVEMENT ASSOCIATION, INC.  
STATEMENT OF CASH FLOWS  
For the Year Ended December 31, 2014

CASH FLOWS FROM/(USED BY) OPERATING ACTIVITIES:	
Net Revenues Over Expenses	\$ 438,741
Adjustments to reconcile excess of revenues over expenses to net cash provided by operating activities:	
Unrealized (gain)/loss on securities	(403,333)
Realized gain on sale of vehicle	-
Depreciation	25,797
Bond amortization	39,526
 (Increase)/decrease in:	
Member annual charges receivable	(48,128)
Interest receivable	6,728
Increase/ (decrease) in:	
Accounts payable	(5,005)
Payroll taxes	6
NET CASH FROM/(USED BY) OPERATING ACTIVITIES	<u>54,332</u>
CASH FLOW PROVIDED/(USED) BY INVESTING ACTIVITIES:	
Investments - purchases	(966,726)
Investments - sales (net of realized gain)	1,025,000
NET CASH (USED)/PROVIDED BY INVESTING ACTIVITIES	<u>58,274</u>
CASH FLOW PROVIDED/(USED) BY FINANCING ACTIVITIES:	
Purchase of lot	(23,996)
NET CASH (USED)/PROVIDED BY FINANCING ACTIVITIES	<u>(23,996)</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	88,610
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	83,053
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u><u>\$ 171,663</u></u>

The accompanying notes are an integral part of these financial statements.



WATERWOOD IMPROVEMENT ASSOCIATION, INC.  
NOTES TO FINANCIAL STATEMENTS

NOTE A – NATURE OF ORGANIZATION

Waterwood Improvement Association, Inc. (WIA) is a non-profit corporation, organized for the purpose of promoting and developing the common good and social welfare of the homeowners of the Waterwood subdivision, including providing for the construction of utilities and the maintenance of roads, common areas, and other improvements. In addition, WIA provides security, EMS service, garbage pickup, fire department and road maintenance for the Waterwood residents. The Waterwood development is located in San Jacinto County and is comprised of more than 1,000 acres of lots and developed home sites, in addition to the greenbelts, roads and other common areas. Currently, approximately 408 improved lots and 1,619 unimproved lots are serviced by WIA.

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting

The Association's governing documents provide certain guidelines for governing its financial activities. In accordance with generally accepted accounting principles, the financial statements have been prepared on the accrual basis. Revenues are recognized when they are earned and expenses are recognized when they are incurred.

Annual Charges

WIA is funded primarily through funds received from annual charges and investment portfolio income. In accordance with the provisions of the land deed covenants, annual charges are levied on all lot owners, with the exception of lots owned by governmental entities and those possessing developer rights. The annual charges are recognized on the active accounts as income at the time they are levied. The annual charges are levied each December 31, and if not paid by the following March 31, become delinquent and bear interest at the rate of ten percent per annum. WIA routinely files liens on lots with houses on which unpaid annual charges exist. All amounts due to WIA are maintained as accounts receivable and the amounts determined to be uncollectible are set up in an allowance for bad debts. Any changes to the allowance for bad debts account will be made by increasing or decreasing bad debt expense or recoveries for the amount of the change.

WATERWOOD IMPROVEMENT ASSOCIATION, INC.  
NOTES TO FINANCIAL STATEMENTS

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

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 those properties are directly associated with the unit (that is, common property without which the units could not be occupied and exterior property that is normally part of a freestanding unit). Common property owned by WIA and not capitalized includes designated park sites, roads, sidewalks, and greenbelts.

The Association capitalizes personal property at cost and depreciates it using the straight-line method over the estimated useful life.

Income Taxes

A qualifying homeowners' association may be taxed either as a homeowners' association or as a regular corporation. As a homeowners' association, annual charge income is exempt from taxation if certain elections are made, and the association is taxed only on its nonmembership income, such as bank or bond interest earnings and gain on sale of certain assets, at regular federal corporate rates. In 2014, WIA qualified under Section 528 of the Internal Revenue Code as a homeowners association and has extended the filing of Form 1120-H.

Statement of Cash Flows

For purposes of reporting cash flows, all highly liquid investments with a maturity of three months or less are considered to be cash equivalents. This includes WIA's investment in the Morgan Stanley Money Market Fund which invests in instruments with a maturity of less than 90 days.

Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

WATERWOOD IMPROVEMENT ASSOCIATION, INC.  
NOTES TO FINANCIAL STATEMENTS

NOTE C – MARKETABLE AND NONMARKETABLE SECURITIES

WIA adopted SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities, which requires classification of securities into one of three categories, depending on the entity’s intent and ability to hold the security until maturity.

All of the bonds held at year end are considered to be “available for sale” according to SFAS No. 115 and are recorded at fair market value.

Realized gains and losses are recorded in the statement of revenues and expenses in the period they are earned. Bond premium/discount is amortized by WIA using the effective-interest method required by SFAS No. 115 as calculated by the investment brokers, Morgan Stanley.

The aggregate cost and market values of the investment securities are summarized as follows:

Available-for-sale securities:

	Amortized <u>Cost</u>	<u>Market</u>	Cumulative Unrealized <u>Gains/(losses)</u>
State and municipal securities with AAA, AA, A and BAA ratings	\$ <u>7,223,772</u>	\$ <u>7,695,263</u>	\$ <u>471,491</u>

During the year ended December 31, 2014, seven bonds were purchased, and seven bonds were called and one bond matured. No bonds were sold for a net realized gain in 2014.

Net unrealized holding gains on available-for-sale securities in the amount of \$403,333 for the year ended December 31, 2014 have been included in accumulated other comprehensive income of \$471,491.

WATERWOOD IMPROVEMENT ASSOCIATION, INC.  
NOTES TO FINANCIAL STATEMENTS

NOTE C - MARKETABLE AND NONMARKETABLE SECURITIES, continued

Maturities of available-for-sale debt securities at December 31, 2014 are as follows:

	Estimated <u>Fair Value</u>
Due in one year or less (before December 31, 2015)	\$ -
Due between January 1, 2016 and December 31, 2019 (1 to 5 years)	883,508
Due between January 1, 2020 and December 31, 2024 (5 to 10 years)	1,252,280
Due between January 1, 2025 and December 31, 2034 (10 to 20 years)	2,253,642
Due January 1, 2035 or after (20 years or more)	<u>3,305,833</u>
Total investment in available-for-sale securities	\$ <u>7,695,263</u>

Actual maturities may differ from contractual maturities because some borrowers have the right to call or prepay obligations with or without call or prepayment penalties. For purposes of this schedule, the actual maturity dates were used.

NOTE D – ASSESSMENTS AND ACCRUED INTEREST ON DELINQUENT RECEIVABLES

Balance, beginning of year	\$ 1,946,620
Plus: Assessments	790,556
Plus: Interest	116,441
Less: Adjustments	(11,681)
Less: Collections/Write offs	(532,466)
Less: Collection agency expense	<u>(30,949)</u>
Balance, end of year	\$ <u>2,278,521</u>

The annual fee for 2014 was \$395 (\$375 for 2013) for single family lots and \$525 for multi-family lots (\$500 in 2013).

WATERWOOD IMPROVEMENT ASSOCIATION, INC.  
NOTES TO FINANCIAL STATEMENTS

NOTE D – ASSESSMENTS AND ACCRUED INTEREST ON DELINQUENT RECEIVABLES (continued)

WIA established an allowance for uncollectible accounts for delinquent assessments in 2008. The net accounts receivable at December 31, 2014 is shown below:

Accounts receivable	\$ 2,278,521
Receivable from collection agency	13,542
Less: Allowance for bad debts	<u>(1,851,627)</u>
Net accounts receivable	\$ <u>440,436</u>

This account is reviewed annually by WIA. The Bad Debt expense for 2014 was \$466,317.

As of December 31, 2014, Waterwood Partners owns 512 unimproved lots, of the 1,619 total undeveloped lots in Waterwood. Waterwood Partners were billed for fees on all lots owned and made a \$15,900 payment for fees in April 2014 for 2013 fees (\$16,000 in 2013 for 2012 fees), but have not made additional payments of fees owed. Negotiations are ongoing to create a plan to further develop Waterwood, which could increase landowner interest and create additional annual charge income for WIA if these lots are sold.

NOTE E – COMMITMENT FOR LAND IMPROVEMENTS

Currently, all lots in the Waterwood subdivision have water and sewer connections, but approximately 200 lots in Park Forest do not have electricity service. According to the warranty deed, Section 2.12, after receipt of the tenth annual fee following the sale of the lot by the developer, and after payment of the capital improvement charge and approval of the Architectural Control Committee (by the issuance of a permit authorizing the construction of a lot improvement), and after furnishing evidence to the Board, WIA has an obligation to supply utility service to an individual lot owner within one year of proper notification to the Board. In 2014, none of these 200 lotholders have paid ten years of fees and therefore, WIA does not currently have an obligation for electricity service in 2014.

WATERWOOD IMPROVEMENT ASSOCIATION, INC.  
NOTES TO FINANCIAL STATEMENTS

NOTE F – CONTINGENT ACCOUNTS RECEIVABLE

On April 9, 2009, WIA filed a lawsuit against Waterwood National for the \$128,159 owed to WIA for security services and signs provided by WIA from 2001 to April 30, 2006, since no payments had been made by Waterwood National in satisfaction of this debt. A default judgment by the court was made in favor of Waterwood Improvement Association and will remain in effect for ten years (can be re-filed at that time) in the event the property is sold and the debt can be paid off. No receivable for this amount is currently recorded, due to the unlikelihood of collection in 2014.

NOTE G – PROPERTY, EQUIPMENT AND OTHER ASSETS

Property and equipment consists of the following categories:

	<u>Cost</u>
Autos	\$ 46,751
Office equipment	25,018
Other equipment	3,749
Common improvements	74,555
Buildings	<u>314,233</u>
Total Property and Equipment	464,306
Less: Accumulated depreciation	<u>(352,813)</u>
Net cost	<u>\$ 111,493</u>

Other assets consist primarily of parkways, public areas (i.e. dump site), acreage, and two lots owned by WIA and are valued at \$297,126, of which \$250,000 represents a strip of land along the east side of Waterwood Parkway, approximately six miles long and 150 feet wide, which was purchased by WIA in order to maintain a no-cut zone in the entrance to the Waterwood subdivision.

NOTE H – FEDERAL INCOME TAX

WIA files Form 1120-H, a U.S. Income Tax Return for Homeowners Associations, annually. The investment policy of WIA encourages investing all bonds in tax-free rather than taxable securities, which is the primary reason for the minimal income tax liability.

WATERWOOD IMPROVEMENT ASSOCIATION, INC.  
NOTES TO FINANCIAL STATEMENTS

NOTE I – DESIGNATED MEMBERS’ EQUITY

Instead of specifically designating Members’ Equity for particular purposes, WIA uses a five-year forecast of income and expenditures model in planning future requirements.

NOTE J – EMS (EMERGENCY MEDICAL SERVICES)

WIA entered into a contract with Allegiance Ambulance, effective January 1, 2014 (through December 31, 2015), for annual compensation of \$96,253 (\$8,021 monthly) to provide emergency medical services to all Waterwood residents.

NOTE K – GROUNDS MAINTENANCE CONTRACT

The three year maintenance contract with JJJ Enterprises for \$114,743 expired on December 31, 2013. A new three-year contract with Julius Currie began January 1, 2014 through December 31, 2016 for \$117,000 annually (\$9,750 monthly).

NOTE L – RELATED PARTY TRANSACTIONS

One member of the WIA Board of Directors is employed by WIA as a part-time security employee. This Board member abstains from any vote regarding matters of security.

NOTE M – SUBSEQUENT EVENTS

The Organization did not have any subsequent events through June 5, 2015, which is the date the financial statements were available to be issued for events requiring recording or disclosure in the financial statements for the year ended December 31, 2014.

*Supplementary Information*





**DAVIS, HEINEMANN & COMPANY, P.C.**

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INDEPENDENT AUDITORS'S REPORT ON  
SUPPLEMENTARY INFORMATION

To the Board of Directors and Property Owners  
Waterwood Improvement Association

The information included in the Schedule of Operating Fund Revenues and Expenses – Budget and Actual for the year ended December 31, 2014 on pages 15-16 is presented only for supplementary analysis purposes. Such information (except for the budget information, which was compiled without audit from information that is the representation of management, on which we did not express an opinion or any other form of assurance) has been subjected to certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

The supplementary information on future major repairs and replacements on page 17 is not a required part of the basic financial statements of WIA but is supplementary information required by the American Institute of Certified Public Accountants. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

A handwritten signature in black ink that reads "Davis, Heinemann &amp; Co." in a cursive script.

Davis, Heinemann & Company, P.C.

June 5, 2015

WATERWOOD IMPROVEMENT ASSOCIATION, INC.  
SCHEDULE OF OPERATING FUND REVENUES AND EXPENSES  
BUDGET AND ACTUAL - BUDGETARY BASIS  
For the Year Ended December 31, 2014

	2014		Variance Favorable (Unfavorable)
	<u>Budget</u>	<u>Actual</u>	
<b>REVENUES</b>			
Annual charges	\$ 790,000	\$ 790,556	\$ 556
Interest on delinquent annual charges	100,000	116,441	16,441
Recoveries	80,000	125,076	45,076
Investment income	335,000	338,066	3,066
Capital improvement charges	1,000	1,000	-
Property transfer fees	1,500	2,200	700
Unrealized gain/(loss) on securities	-	403,333	403,333
Fireworks donations	3,300	3,290	(10)
Gain on sale of assets	-	-	-
WNN ads	-	250	250
Other income	3,200	3,100	(100)
Total Revenue	<u>1,314,000</u>	<u>1,783,312</u>	<u>469,312</u>
<b>EXPENSES</b>			
Vehicle fuel	8,000	7,472	528
Vehicle repairs and maintenance	5,000	3,846	1,154
Bad debt expense	491,400	466,317	25,083
Fire station repairs and maintenance	500	75	425
Office building repairs & maintenance	4,000	3,614	386
Business licenses and permits	1,500	1,004	496
Fireworks	5,000	4,994	6
Decorations	3,500	2,200	1,300
Socials	5,500	5,477	23
EMS contract	96,250	96,253	(3)
Vehicle liability insurance	2,800	2,735	65
Employee medical insurance	3,500	2,928	572
Security liability insurance	3,600	3,661	(61)
Directors & officers liability insurance	4,700	4,909	(209)
Property and general liability insurance	7,500	8,001	(501)
Workers compensation insurance	2,500	2,224	276
WVFD insurance	7,000	6,480	520
Landscaping	500	352	148
Grounds maintenance contract	117,000	116,812	188
Miscellaneous	2,000	1,391	609
Dues and subscriptions	600	408	192
Computer equipment and software	2,500	3,466	(966)

WATERWOOD IMPROVEMENT ASSOCIATION, INC.  
SCHEDULE OF OPERATING FUND REVENUES AND EXPENSES  
BUDGET AND ACTUAL - BUDGETARY BASIS - continued  
For the Year Ended December 31, 2014

	2014		Variance Favorable (Unfavorable)
	<u>Budget</u>	<u>Actual</u>	
Janitorial	2,500	2,388	112
Postage and shipping	4,000	4,329	(329)
Printing	4,000	4,141	(141)
Supplies	3,600	4,142	(542)
Salaries	235,000	232,757	2,243
Auditing/Accounting	10,750	10,750	-
Legal	10,000	13,924	(3,924)
Equipment rental	2,600	-	2,600
Road repairs and maintenance	100,000	114,605	(14,605)
Payroll taxes	18,800	18,544	256
Real estate taxes	7,500	7,513	(13)
Federal Income Tax	1,000	701	299
Travel and meals	550	665	(115)
Alarm monitoring	400	364	36
Electricity	35,000	30,992	4,008
Garbage pickup	36,000	35,443	557
Telephone and communications	8,000	7,479	521
Water	600	685	(85)
Waterwood Volunteer Fire Department	7,000	8,887	(1,887)
Lease payments	6,185	6,185	-
Collection expense (including sales tax)	13,000	30,135	(17,135)
Total Budgeted Expenses	<u>1,281,335</u>	<u>1,279,248</u>	<u>2,087</u>
EXCESS OF REVENUES/(EXPENSES) OVER MAJOR BUDGETED EXPENSES/REVENUES	<u>32,665</u>	<u>504,064</u>	<u>471,399</u>
OTHER BUDGETED EXPENSES			
Depreciation expense	26,000	25,797	203
Bond premium/discount amortization	45,000	39,526	5,474
Capital Expenditures - Other	25,000	23,396	1,604
Total Other-Budgeted Expenses	<u>96,000</u>	<u>88,719</u>	<u>7,281</u>
EXCESS OF REVENUES/(EXPENSES) OVER EXPENSES/REVENUES	<u>\$ (63,335)</u>	<u>\$ 415,345</u>	<u>\$ 478,680</u>

WATERWOOD IMPROVEMENT ASSOCIATION, INC.  
SUPPLEMENTARY INFORMATION ON FUTURE MAJOR REPAIRS AND  
REPLACEMENTS (COMPILED)

At some time in the future, major repairs on the road surfaces may be required. The extent of any major repairs or resurfacing will have to be assessed on a case-by-case basis. San Jacinto County is responsible for all subdivision road maintenance as evidenced by an easement granted to the County in 1979. If WIA determines that an additional project is necessary and the County will not fund the necessary work, and additional funds, beyond current operating funds, are required to meet future needs, the Association can borrow money or delay the work until funds are available. The Association would only borrow money in the event that the County will not complete necessary improvements to the roads. The last complete resurfacing of all roads in 1992 cost WIA approximately \$1,500,000.