

**WATERWOOD IMPROVEMENT ASSOCIATION, INC.**

*FINANCIAL STATEMENTS AND SUPPLEMENTARY INFORMATION*

*FOR THE YEAR ENDED DECEMBER 31, 2015*



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

*Certified Public Accountants*

1300 11th Street Suite 500

Huntsville, Texas 77340

(936) 291-3020

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

*CERTIFIED PUBLIC ACCOUNTANTS*

1300 11TH STREET, SUITE 500

P.O. BOX 6308

HUNTSVILLE, TEXAS 77342

PHONE (936) 291-3020

FAX (936) 291-9607

**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, 2015, 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, 2015, 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,

*Davis, Heinemann & Co.*

Davis, Heinemann & Company, P.C.

Huntsville, Texas

July 1, 2016

WATERWOOD IMPROVEMENT ASSOCIATION, INC.  
BALANCE SHEET  
December 31, 2015

ASSETS

Cash and cash equivalents, including interest-bearing deposits	\$	94,441
Annual charges receivable and accrued interest on delinquent receivables, less allowance for bad debts		417,731
Accrued interest receivable		103,646
Investments		7,731,166
Property and equipment, less accumulated depreciation		112,272
Other assets		297,126
<b>TOTAL ASSETS</b>	<b>\$</b>	<b><u>8,756,382</u></b>

LIABILITIES AND MEMBERS' EQUITY

Accounts payable and other accrued liabilities	\$	8,400
Capital improvement deposits		3,000
Payroll taxes payable		405
<b>Total Liabilities</b>		<b><u>11,805</u></b>
 Members' Equity		
Designated for current and future obligations		8,310,688
Accumulated other comprehensive income		433,889
<b>Total Members' Equity</b>		<b><u>8,744,577</u></b>
 <b>TOTAL LIABILITIES AND MEMBERS' EQUITY</b>	<b>\$</b>	<b><u>8,756,382</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, 2015

REVENUES

Annual charges	\$ 815,880
Interest on delinquent annual charges	142,756
Recoveries	43,112
Investment income	337,975
Capital improvement charges	3,000
Property transfer fees	2,700
Unrealized gain/(loss) on securities	(37,602)
Loss on sale of assets	(200)
Donations	3,995
Other income	863
Total Revenue	<u>1,312,479</u>

EXPENSES

Vehicle expense	19,524
Bad debts	552,942
Repairs and maintenance - buildings	2,255
Licenses and fees	701
Community events	11,825
EMS contract	96,253
Insurance	37,549
Grounds maintenance contract	117,442
Miscellaneous	6,230
Office expense	17,204
Salaries and payroll tax	256,088
Professional fees	33,859
Road repair and maintenance	50,914
Taxes	7,187
Travel and meals	727
Utilities and services	78,333
Depreciation	25,462
Bond amortization	34,279
Waterwood Volunteer Fire Department	12,956
Lease payments	6,165
Collection expense	10,688
Total Expenses	<u>1,378,583</u>

Excess Revenues Over Expenses	<u>\$ (66,104)</u>
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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, 2015

MEMBERS' EQUITY, BEGINNING OF YEAR	\$ 8,810,681
Excess Expenses Over Revenues	<u>(66,104)</u>
MEMBERS' EQUITY, END OF YEAR	<u>\$ 8,744,577</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, 2015

CASH FLOWS FROM/(USED BY) OPERATING  
ACTIVITIES:

Net Revenues Over Expenses	\$	(66,104)
Adjustments to reconcile excess of expenses over revenues to net cash provided by operating activities:		
Unrealized (gain)/loss on securities		37,602
Realized (gain)/loss on sale of vehicle		200
Depreciation		25,462
Bond amortization		34,279
(Increase)/decrease in:		
Member annual charges receivable		22,705
Interest receivable		656
Increase/ (decrease) in:		
Accounts payable		1,231
Capital improvement Deposits		1,000
Payroll taxes		(28)
NET CASH FROM/(USED BY) OPERATING ACTIVITIES		57,003

CASH FLOWS PROVIDED/(USED) BY INVESTING  
ACTIVITIES:

Investments - purchases		(607,784)
Investments - sales		500,000
Purchase of vehicle		(28,241)
Disposal of vehicle - trade-in		1,800
NET CASH (USED)/PROVIDED BY INVESTING ACTIVITIES		(134,225)

NET INCREASE IN CASH AND CASH EQUIVALENTS		(77,222)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR		171,663
CASH AND CASH EQUIVALENTS AT END OF YEAR	\$	94,441

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



WATERWOOD IMPROVEMENT ASSOCIATION, INC.  
NOTES TO FINANCIAL STATEMENTS  
For the Year Ended December 31, 2015

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  
For the Year Ended December 31, 2015

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 2015, 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:

	<u>Amortized Cost</u>	<u>Market</u>	<u>Cumulative Unrealized Gains/(losses)</u>
State and municipal securities with AAA, AA, A and BAA ratings	\$ <u>7,297,277</u>	\$ <u>7,731,166</u>	\$ <u>433,889</u>

During the year ended December 31, 2015, four bonds were purchased, and two bonds were called. No bonds were sold for a net realized gain in 2015.

Net unrealized holding losses on available-for-sale securities in the amount of \$37,602 for the year ended December 31, 2015 have been included in accumulated other comprehensive income of \$433,889.

WATERWOOD IMPROVEMENT ASSOCIATION, INC.  
 NOTES TO FINANCIAL STATEMENTS  
 For the Year Ended December 31, 2015

NOTE C - MARKETABLE AND NONMARKETABLE SECURITIES, continued

Maturities of available-for-sale debt securities at December 31, 2015 are as follows:

	<u>Estimated Fair Value</u>
Due in one year or less (before December 31, 2016)	\$ -
Due between January 1, 2017 and December 31, 2020 (1 to 5 years)	515,991
Due between January 1, 2021 and December 31, 2025 (5 to 10 years)	1,462,064
Due between January 1, 2026 and December 31, 2035 (10 to 20 years)	2,220,333
Due January 1, 2036 or after (20 years or more)	<u>3,532,778</u>
Total investment in available-for-sale securities	<u>\$ 7,731,166</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	\$ 2,278,521
Plus: Assessments	815,880
Plus: Interest	142,756
Plus: Adjustments	5,218
Less: Collections/Write offs	(509,536)
Less: Collection agency expense	<u>(10,688)</u>
Balance, end of year	<u>\$ 2,722,151</u>

The annual fee for 2015 was \$415 (\$395 for 2014) for single family lots and \$545 for multi-family lots (\$525 in 2014).

WATERWOOD IMPROVEMENT ASSOCIATION, INC.  
NOTES TO FINANCIAL STATEMENTS  
For the Year Ended December 31, 2015

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, 2015 is shown below:

Accounts receivable	\$ 2,722,151
Less: Allowance for bad debts	(2,304,520)
Net accounts receivable	\$ <u>417,731</u>

This account is reviewed annually by WIA. The Bad Debt expense for 2015 was \$552,942.

As of December 31, 2015, Waterwood Partners and its affiliate, Investor Land Services, owns 531 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. The Organization has sued Waterwood Partners and Investor Land Services for the fees and interest owed, which is expected to be settled in mediation during 2016.

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 2015, none of these 200 lotholders have paid ten years of fees and therefore, WIA does not currently have an obligation for electricity service in 2015.

WATERWOOD IMPROVEMENT ASSOCIATION, INC.  
NOTES TO FINANCIAL STATEMENTS  
For the Year Ended December 31, 2015

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 2015.

NOTE G – PROPERTY, EQUIPMENT AND OTHER ASSETS

Property and equipment consists of the following categories:

	<u>Cost</u>
Autos	\$ 55,244
Office equipment	25,018
Other equipment	3,749
Common improvements	74,555
Buildings	<u>314,233</u>
Total Property and Equipment	472,799
Less: Accumulated depreciation	<u>(360,527)</u>
Net cost	\$ <u>112,272</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  
For the Year Ended December 31, 2015

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. The contract was renewed for an additional two years at the same rate effective January 1, 2016.

NOTE K – GROUNDS MAINTENANCE CONTRACT

A 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

No related party transactions were noted during 2015.

NOTE M – SUBSEQUENT EVENTS

The Organization had several subsequent events through July 1, 2016, 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, 2015.

The Organization bought real estate for \$1,000,000 in March 2016.

In addition, the Board passed a capital projects budget of \$657,000 for capital expenditures expected to be completed by 2017. Of this amount, approximately \$500,000 has been or is expected to be spent on park facilities (including a swimming pool, pavilion and playground) and a trailer/RV storage area. In addition, approximately \$150,000 is expected to be spent on a culvert replacement and an additional \$7,000 on the new billboard renovations. Finally, the Organization committed to spend approximately \$48,000 per year for mowing the golf course, beginning January 1, 2016.

## *Required Supplementary Information*

Required supplementary information includes financial information and disclosures required by the Governmental Accounting Standards Board but not considered a part of the basic financial statements.





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

*CERTIFIED PUBLIC ACCOUNTANTS*

1300 11TH STREET, SUITE 500

P.O. BOX 6308

HUNTSVILLE, TEXAS 77342

PHONE (936) 291-3020

FAX (936) 291-9607

INDEPENDENT AUDITOR'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, 2015 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.

Sincerely,

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

Davis, Heinemann & Company, P.C.

July 1, 2016

WATERWOOD IMPROVEMENT ASSOCIATION, INC.  
SCHEDULE OF OPERATING FUND REVENUES AND EXPENSES  
BUDGET AND ACTUAL - BUDGETARY BASIS  
For the Year Ended December 31, 2015

	2015		Variance Favorable (Unfavorable)
	<u>Budget</u>	<u>Actual</u>	
<b>REVENUES</b>			
Annual charges	\$ 821,700	\$ 815,880	\$ (5,820)
Interest on delinquent annual charges	100,000	142,756	42,756
Recoveries	45,000	43,112	(1,888)
Investment income	335,000	337,975	2,975
Capital improvement charges	3,000	3,000	-
Property transfer fees	2,800	2,700	(100)
Unrealized gain/(loss) on securities	1,000	(37,602)	(38,602)
Fireworks donations	4,000	3,995	(5)
Gain/(loss) on sale of assets	-	(200)	(200)
WNN ads	150	150	-
Other income	100	713	613
Total Revenue	1,312,750	1,312,479	(271)
<b>EXPENSES</b>			
Vehicle fuel	6,000	6,175	(175)
Vehicle repairs and maintenance	15,000	13,349	1,651
Bad debt expense	502,550	552,942	(50,392)
Fire station repairs and maintenance	700	618	82
Office building repairs & maintenance	1,500	1,637	(137)
Business licenses and permits	641	701	(60)
Fireworks	5,000	5,000	-
Decorations	1,500	630	870
Socials	6,000	6,195	(195)
EMS contract	96,253	96,253	-
Vehicle liability insurance	3,080	3,283	(203)
Employee medical insurance	7,700	7,314	386
Security liability insurance	3,630	3,631	(1)
Directors & officers liability insurance	5,308	5,308	-
Property and general liability insurance	6,500	6,487	13
Workers compensation insurance	4,235	4,235	-
WVFD insurance	7,290	7,291	(1)
Landscaping	550	442	108
Grounds maintenance contract	117,000	117,000	-
Miscellaneous	4,500	6,229	(1,729)
Computer equipment and software	762	849	(87)
Dues and subscriptions	500	617	(117)

WATERWOOD IMPROVEMENT ASSOCIATION, INC.  
SCHEDULE OF OPERATING FUND REVENUES AND EXPENSES  
BUDGET AND ACTUAL - BUDGETARY BASIS - continued  
For the Year Ended December 31, 2015

	2015		Variance Favorable (Unfavorable)
	<u>Budget</u>	<u>Actual</u>	
Janitorial	2,300	2,130	170
Postage and shipping	4,500	4,258	242
Printing	5,400	5,102	298
Supplies	3,500	4,249	(749)
Salaries	236,000	237,251	(1,251)
Auditing/Accounting	10,750	10,750	-
Legal	25,000	23,109	1,891
Road repairs and maintenance	75,000	50,914	24,086
Federal Income Tax	37	37	-
Payroll taxes	18,880	18,837	43
Real estate taxes	7,725	7,150	575
Travel and meals	700	727	(27)
Alarm monitoring	400	364	36
Electricity	36,050	34,056	1,994
Garbage pickup	37,080	34,513	2,567
Telephone and communications	8,240	8,602	(362)
Water	800	798	2
Waterwood Volunteer Fire Department	13,000	12,956	44
Lease payments	6,165	6,165	-
Collection expense (including sales tax)	12,000	10,688	1,312
Total Budgeted Expenses	<u>1,299,726</u>	<u>1,318,842</u>	<u>(19,116)</u>
EXCESS OF REVENUES/(EXPENSES) OVER MAJOR BUDGETED EXPENSES/REVENUES	<u>13,024</u>	<u>(6,363)</u>	<u>(19,387)</u>
OTHER BUDGETED EXPENSES			
Depreciation expense	30,000	25,462	4,538
Bond premium/discount amortization	28,000	34,279	(6,279)
Total Other-Budgeted Expenses	<u>58,000</u>	<u>59,741</u>	<u>(1,741)</u>
EXCESS OF REVENUES/(EXPENSES) OVER EXPENSES/REVENUES	<u>\$ (44,976)</u>	<u>\$ (66,104)</u>	<u>\$ (21,128)</u>

WATERWOOD IMPROVEMENT ASSOCIATION, INC.  
SUPPLEMENTARY INFORMATION ON FUTURE MAJOR REPAIRS AND  
REPLACEMENTS (COMPILED)  
For the Year Ended December 31, 2015

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. In 2016, WIA plans to spend \$150,000 on replacing an existing culvert.