

WATERWOOD IMPROVEMENT ASSOCIATION, INC.

*FINANCIAL STATEMENTS AND SUPPLEMENTARY INFORMATION*

*FOR THE YEAR ENDED DECEMBER 31, 2018*



**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, 2018, 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, 2018, 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 & Company, P.C.  
Huntsville, Texas

August 26, 2019

WATERWOOD IMPROVEMENT ASSOCIATION, INC.  
BALANCE SHEET  
As of December 31, 2018

ASSETS

Cash and cash equivalents, including interest-bearing deposits	\$	245,557
Annual charges receivable and accrued interest on delinquent receivables, less allowance for bad debts		675,945
Accrued interest receivable		63,520
Prepaid expense		21,959
Investments		5,773,934
Land		1,318,328
Property and equipment, less accumulated depreciation		489,294
<b>TOTAL ASSETS</b>	<b>\$</b>	<b><u>8,588,537</u></b>

LIABILITIES AND MEMBERS' EQUITY

Accounts payable and other accrued liabilities	\$	56,769
Capital improvement deposits		1,000
Payroll taxes payable		335
<b>Total Liabilities</b>		<b><u>58,104</u></b>
 Members' Equity		
Designated for current and future obligations		8,386,491
Accumulated other comprehensive income		143,942
<b>Total Members' Equity</b>		<b><u>8,530,433</u></b>
 <b>TOTAL LIABILITIES AND MEMBERS' EQUITY</b>	<b>\$</b>	<b><u>8,588,537</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, 2018

REVENUES

Annual charges	\$ 719,675
Interest on delinquent annual charges	174,877
Recoveries	39,239
Sign rental income	3,000
Investment income	253,130
Capital improvement charges	8,000
Property transfer fees	8,300
Unrealized gain/(loss) on securities	(174,367)
Other income	39,484
Total Revenues	1,071,338

EXPENSES

Vehicle expense	7,763
Bad debts	138,646
Repairs and maintenance - buildings	16,951
Licenses and fees	1,262
Community events	1,894
EMS contract	96,253
Insurance	41,028
Interest Expense	-
Grounds maintenance contract and landscaping	116,095
Miscellaneous	5,565
Office expense	18,636
Salaries and payroll tax	225,199
Professional fees	11,200
Pool maintainance	7,508
Road repair and maintenance	34,750
Golf course maintenance	45,000
Property Taxes	3,337
Travel and meals	-
Utilities and services	84,385
Depreciation	53,457
Bond amortization	21,692
Waterwood Volunteer Fire Department	75,837
Collection expense	2,321
Total Expenses	1,008,779

Excess Revenues Over Expenses	\$ 62,559
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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, 2018

MEMBERS' EQUITY, BEGINNING OF YEAR	\$ 8,467,874
Excess Expenses Over Revenues	<u>62,559</u>
MEMBERS' EQUITY, END OF YEAR	<u><u>\$ 8,530,433</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, 2018

CASH FLOWS FROM/(USED BY) OPERATING  
ACTIVITIES:

Net Revenues Over Expenses	\$	62,559
Adjustments to reconcile excess of expenses over revenues to net cash provided by operating activities:		
Unrealized (gain)/loss on securities		174,367
Depreciation		53,457
Bond amortization		21,692
(Increase)/decrease in:		
Member annual charges receivable		(245,945)
Interest receivable		9,777
Increase/ (decrease) in:		
Accounts payable		43,276
Capital improvement deposits		(1,000)
Payroll taxes		(75)
NET CASH FROM/(USED BY) OPERATING ACTIVITIES		118,108

CASH FLOWS PROVIDED/(USED) BY INVESTING/FINANCING  
ACTIVITIES:

Investments - purchases		(792,408)
Investments - sales		835,000
NET CASH (USED)/PROVIDED BY INVESTING ACTIVITIES		42,592

NET INCREASE IN CASH AND CASH EQUIVALENTS		160,700
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR		84,857
CASH AND CASH EQUIVALENTS AT END OF YEAR	\$	245,557

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, 2018

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 common areas and other improvements. In addition, WIA provides security, EMS service, garbage pickup and fire department services for 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 greenbelts and other common areas. The Waterwood Subdivision has approximately 2,000 lots, of which approximately 400 are improved.

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 and other legal agreements, annual charges are levied on all lot owners, with the exception of lots owned by governmental entities, those exempted under the terms of legal agreements with WIA, and those owned by WIA. The annual charges are recognized on the active accounts as income at the time they are levied. The annual charges are levied each October 31 (November in 2018), and if not paid by December 31 (March 31 in 2018), 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.

### 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). Greenbelts are an example of common property owned by WIA and not capitalized.

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 non-membership income, such as bank or taxable bond interest earnings and gain on sale of certain assets, at regular federal corporate rates. In 2018, 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.

### 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. In addition, the Association has adopted SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, which describes the timing and ability of an entity to use fair value accounting.

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>5,629,992</u>	\$ <u>5,773,934</u>	\$ <u>143,942</u>

During the year ended December 31, 2018, seven bonds were purchased and nine bonds were called for a net realized gain of \$441 in 2018.

Net unrealized holding losses on available-for-sale securities in the amount of \$174,367 for the year ended December 31, 2018 have been included in accumulated other comprehensive income of \$143,942.

Maturities of available-for-sale debt securities at December 31, 2018 are as follows:

	<u>Estimated Fair Value</u>
Due in one year or less (before December 31, 2019)	\$ 30,076
Due between January 1, 2020 and December 31, 2023 (1 to 5 years)	65,168
Due between January 1, 2024 and December 31, 2028 (5 to 10 years)	200,455
Due between January 1, 2029 and December 31, 2038 (10 to 20 years)	2,703,706
Due January 1, 2039 or after (20 years or more)	<u>2,774,529</u>
Total investment in available-for-sale securities	\$ <u>5,773,934</u>

Actual maturities may differ from contractual maturities because nearly all 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	\$ 2,939,437
Plus: Assessments	719,675
Plus: Interest	174,877
Plus: Miscellaneous Other Billings	47,796
Less: Collections/Write offs	(773,798)
Less: Adjustments	(1,416)
Less: Collection agency expense	<u>(1,065)</u>
Balance, end of year	\$ <u>3,105,506</u>

The annual fee for 2018 was \$515 for single family lots (\$500 in 2017) and \$645 for multi-family lots (\$630 in 2017).

WIA established an allowance for uncollectible accounts for delinquent assessments in 2008. The net accounts receivable at December 31, 2018 is shown below:

Accounts receivable	\$ 3,105,506
Less: Allowance for bad debts	<u>(2,429,561)</u>
Net accounts receivable	\$ <u>675,945</u>

This account is reviewed annually by WIA. The Bad Debt expense for 2018 was \$138,646. In 2018, WIA began adjusting the Allowance for Bad Debts account at the end of the year following the year of billing, based on the amount actually collected during that year. Net Accounts Receivable is determined by the properties billed in 2018 (\$723,325), less amounts actually collected in 2018 (\$47,380). In 2017, the Allowance account was adjusted to the amount expected to be collected during the subsequent year at year-end.

As of December 31, 2015, WWP, meaning Waterwood Partners, LLC and any affiliate entities, including ILS (Investor Land Services), owned 531 of the 1,619 total undeveloped lots in Waterwood. Although WWP and ILS were billed for fees on all their lots, they made only nominal payments of fees owed.

In 2015, WIA sued WWP and ILS for the fees and interest owed. A settlement agreement to the lawsuit was reached by mediation in August 2016 which was officially recorded at the Courthouse in January 2018. Major terms of the settlement are as follows:

- 1) WWP and ILS will, upon the closing of the sale of each lot they own in the Waterwood subdivision, pay an amount equal to 15% of the gross sales price to WIA.
- 2) WWP and ILS will convey title to various lots in Park Forest Village without ready access to electricity to WIA, at no cost to WIA. In January 2017, 164 lots were transferred.
- 3) WWP and ILS will pay all future costs to develop undeveloped lots in Tournament Village, Piney Point, Fairway Village, and their remaining lots in Park Forest Village.
- 4) WIA will not bill WWP and ILS annual fees for lots they own for five years from 2016 through July 2021.

Annual fees billed as of December 31, 2018, reflect the fact that WWP and ILS were not billed for the lots they owned (per the terms of the August 2016 settlement agreement).

#### NOTE E – COMMITMENT FOR LAND IMPROVEMENTS

On October 9, 2018, a change to Section 2.12 of the General Warranty Deed was made to remove the requirement that WIA is to put utilities on an unimproved property once the dues have been paid on the property for ten years. The change to the General Warranty Deed as well as other changes to deed restrictions was made after ballots were mailed and approved by the property owners' return of the required ballots by October 9, 2018. Therefore, WIA has no further responsibility for land improvements for lots in the Waterwood subdivision.

#### 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 (could 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 was ever recorded, due to the unlikelihood of collection.

In 2018, WIA reached an agreement with Waterwood National to forgive the debt of Waterwood National if they would repair the bulkhead in the marina/beach area, which they completed in September 2018. Therefore, the prior contingent accounts receivable liability was eliminated.

## NOTE G – LAND AND PROPERTY AND EQUIPMENT

Land and property and equipment consists of the following categories:

<u>Cost</u>	
Land	\$1,318,328
Autos	55,244
Office equipment	25,018
Other equipment	3,749
Common improvements	128,707
Buildings	<u>770,884</u>
Total Property and Equipment	2,301,930
Less: Accumulated depreciation	(494,308)
Net cost	<u>\$1,807,622</u>

Land consists primarily of parkways, public areas (i.e. dump site), acreage, and 165 lots owned by WIA and is valued at \$1,318,328, 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.

In 2016, WIA purchased, for \$1,006,513, the parkway right of way from FM 980 to Bob Christian Road, the parkway right of way from State Highway 190 to where the parkway becomes a two lane road, and the billboard, plus the land surrounding the billboard, located on the south side of State Highway 190 across from Waterwood Parkway. In addition, WIA obtained the right to approve the posting of signs and placement of any items within 200 feet of the parkway right of way and within 200 feet of the rights of way of a number of other roads within Waterwood.

## 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.

## 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 renewed its contract with Allegiance Ambulance, effective January 1, 2018 (through December 31, 2019), for annual compensation of \$96,253 (\$8,021 monthly) to provide emergency medical services to all Waterwood residents.

NOTE K – GROUNDS MAINTENANCE CONTRACT

Effective January 21, 2018 and extending until January 22, 2021, Timberlake Nursery received a three-year contract to provide grounds maintenance for \$9,073 per month (including sales tax), with additional services billed separately.

NOTE L – RELATED PARTY TRANSACTIONS

No related party transactions were noted during 2018.

NOTE M – SUBSEQUENT EVENTS

The Association had no reportable subsequent events through August 26, 2019, 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, 2018.

**SUPPLEMENTARY INFORMATION**





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

*CERTIFIED PUBLIC ACCOUNTANTS*

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**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, 2018 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, appearing to read 'Davis, Heinemann &amp; Co', written in a cursive style.

Davis, Heinemann & Company, P.C.  
August 26, 2019

WATERWOOD IMPROVEMENT ASSOCIATION, INC.  
SCHEDULE OF OPERATING FUND REVENUES AND EXPENSES  
BUDGET AND ACTUAL - BUDGETARY BASIS  
For the Year Ended December 31, 2018

	2018		Variance Favorable (Unfavorable)
	<u>Budget</u>	<u>Actual</u>	
<b>Revenues</b>			
Annual charges	\$ 430,500	\$ 719,675	\$ 289,175
Interest on delinquent annual charges	-	174,877	174,877
Recoveries	30,000	39,239	9,239
Investment income	290,000	253,130	(36,870)
Sign rentals	3,000	3,000	-
Capital improvement charges	4,000	8,000	4,000
Property transfer fees	5,000	8,300	3,300
Unrealized gain/(loss) on securities	-	(174,367)	(174,367)
Fireworks donations	4,000	-	(4,000)
Insurance proceeds	-	13,302	13,302
Trailer park maintenace & operating fee	3,000	2,500	(500)
Pool pass maintenace & operating fee	9,000	8,250	(750)
Lot consolidation fee	4,000	-	(4,000)
WWP lot sales	-	15,392	15,392
Other income	100	40	(60)
Total Revenue	<u>782,600</u>	<u>1,071,338</u>	<u>288,738</u>
<b>Expenses</b>			
Vehicle expense	11,000	7,763	3,237
Bad debts	-	138,646	(138,646)
Buildings repair and maintenance	650	16,951	(16,301)
Licenses and fees	1,500	1,262	238
Community events	8,500	1,894	6,606
EMS contract	96,253	96,253	-
Insurance	35,750	41,028	(5,278)
Interest expense	7,000	-	7,000
Grounds maintenance contract & landscape	110,500	116,095	(5,595)
Miscellaneous	2,000	5,565	(3,565)
Office expense	22,800	18,636	4,164
Salaries and payroll tax	227,100	225,199	1,901
Professional fees	30,750	11,200	19,550
Pool maintainance	8,000	7,508	492
Road repair and maintenance	42,000	34,750	7,250
Golf course maintenance	45,000	45,000	-
Property taxes	5,000	3,337	1,663
Travel and meals	1,600	-	1,600

WATERWOOD IMPROVEMENT ASSOCIATION, INC.  
SCHEDULE OF OPERATING FUND REVENUES AND EXPENSES  
BUDGET AND ACTUAL - BUDGETARY BASIS - continued  
For the Year Ended December 31, 2018

	2018		Variance Favorable (Unfavorable)
	<u>Budget</u>	<u>Actual</u>	
Utilities and services	77,400	84,385	(6,985)
Waterwood Volunteer Fire Department	25,750	75,837	(50,087)
Collection expense	5,000	2,321	2,679
Total Budgeted Expenses	<u>763,553</u>	<u>933,630</u>	<u>(170,077)</u>
EXCESS OF REVENUES/(EXPENSES) OVER MAJOR BUDGETED EXPENSES/REVENUES	<u>19,047</u>	<u>137,708</u>	<u>118,661</u>
OTHER BUDGETED EXPENSES			
Depreciation expense	-	53,457	(53,457)
Bond premium/discount amortization	-	21,692	(21,692)
Total Other-Budgeted Expenses	<u>-</u>	<u>75,149</u>	<u>(75,149)</u>
EXCESS OF REVENUES/(EXPENSES) OVER EXPENSES/REVENUES	<u>\$ 19,047</u>	<u>\$ 62,559</u>	<u>\$ 43,512</u>

WATERWOOD IMPROVEMENT ASSOCIATION, INC.  
SUPPLEMENTARY INFORMATION ON FUTURE MAJOR REPAIRS AND  
REPLACEMENTS (COMPILED)  
For the Year Ended December 31, 2018

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.