

WATERWOOD IMPROVEMENT ASSOCIATION, INC.

FINANCIAL STATEMENTS AND SUPPLEMENTARY INFORMATION

FOR THE YEAR ENDED DECEMBER 31, 2019



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, 2019, and the related statements of activities, 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, 2019, 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

May 29, 2020

Waterwood Improvement Association, Inc.
Balance Sheet
As of December 31, 2019

ASSETS

Cash and cash equivalents, including interest-bearing deposits	\$ 604,988
Annual charges receivable and accrued interest on delinquent receivables, less allowance for bad debts	350,457
Accrued interest receivable	58,094
Prepaid expense	17,421
Investments	5,897,040
Land	1,318,329
Property and equipment, less accumulated depreciation	<u>492,865</u>

TOTAL ASSETS \$ 8,739,194

LIABILITIES AND MEMBERS' EQUITY

LIABILITIES

Accounts payable and other accrued liabilities	\$ 15,244
Capital improvement deposits	3,000
Payroll taxes payable	311

TOTAL LIABILITIES 18,555

MEMBERS' EQUITY

Designated for current and future obligations	8,362,019
Accumulated other comprehensive income	358,620

TOTAL MEMBERS' EQUITY 8,720,639

TOTAL LIABILITIES AND MEMBERS' EQUITY \$ 8,739,194

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

Waterwood Improvement Association, Inc.
Statement of Activities
For the Year Ended December 31, 2019

REVENUES

Annual charges	\$ 687,075
Interest on delinquent annual charges	181,442
Recoveries	31,091
Investment income	249,902
Sign rentals	2,750
Capital improvement charges	43,000
Property transfer fees	5,700
Unrealized gain/(loss) on securities	214,678
Fireworks donations	2,755
Trailer park maintenace & operating fee	2,400
Pool pass maintenace & operating fee	7,800
WWP lot sales	25,954
Other income	41
Gain/(loss) on sale of assets	1,000
Total Revenues	<u>1,455,588</u>

EXPENSES

Vehicle expense	8,599
Bad debts	482,653
Repairs and maintenance - buildings	3,208
Licenses and fees	843
Community events	5,504
EMS contract	96,253
Insurance	36,644
Grounds maintenance contract and landscaping	110,023
Miscellaneous	2,788
Office expense	20,098
Salaries and payroll tax	210,473
Professional fees	29,662
Pool maintainance	8,514
Road repair and maintenance	58,820
Golf course maintenance	44,490
Property taxes	3,349
Travel and meals	-
Utilities and services	73,096
Depreciation	45,991
Bond amortization	16,414
Waterwood Volunteer Fire Department	518
Collection expense	-
Contract labor	7,442
Total Expenses	<u>1,265,382</u>

**EXCESS (DEFICIENCY) OF REVENUES
OVER (UNDER) EXPENSES**

\$ 190,206

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, 2019**

MEMBERS' EQUITY, BEGINNING OF YEAR	\$ 8,530,433
Excess Revenues Over Expenses	<u>190,206</u>
MEMBERS' EQUITY, END OF YEAR	<u><u>\$ 8,720,639</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, 2019

CASH FLOWS FROM OPERATING ACTIVITIES	
Net Revenues Over Expenses	\$ 190,206
Adjustments to reconcile excess of expenses over revenues to net cash provided by operating activities:	
Unrealized (gain)/loss on securities	(214,678)
Depreciation	45,991
Bond amortization	16,414
(Increase)/decrease in:	
Member annual charges receivable	325,488
Interest receivable	5,426
Prepaid expense	4,538
Increase/ (decrease) in:	
Accounts payable	(41,525)
Capital improvement deposits	2,000
Payroll taxes	(24)
NET CASH FROM/(USED BY) OPERATING ACTIVITIES	<u>333,836</u>
CASH FLOWS FROM INVESTING ACTIVITIES	
Investments - purchases	(219,842)
Investments - sales	295,000
Fixed Asset Purchase	(49,563)
NET CASH (USED)/PROVIDED BY INVESTING ACTIVITIES	<u>25,595</u>
CASH FLOWS FROM FINANCING ACTIVITIES	
Interest paid	-
Loan proceeds	-
Reduction in long-term debt	-
NET CASH (USED)/PROVIDED BY FINANCING ACTIVITIES	<u>-</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	359,431
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	245,557
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u>\$ 604,988</u>

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, 2019

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 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 2019), and if not paid by December 31, become delinquent and bear interest at the rate of ten percent per annum. WIA, when appropriate, 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 greater than \$5,000 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 2019, 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 and Invesco Mutual 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>5,538,420</u>	\$ <u>5,897,040</u>	\$ <u>358,620</u>

During the year ended December 31, 2019, two bonds were purchased and five bonds were called for a net realized gain of \$0 in 2019.

Net unrealized holding gains on available-for-sale securities in the amount of \$214,678 for the year ended December 31, 2019 have been included in accumulated other comprehensive income of \$358,620.

Maturities of available-for-sale debt securities at December 31, 2019 are as follows:

	<u>Estimated Fair Value</u>
Due in one year or less (before December 31, 2020)	\$ -
Due between January 1, 2021 and December 31, 2024 (1 to 5 years)	-
Due between January 1, 2025 and December 31, 2029 (5 to 10 years)	150,888
Due between January 1, 2030 and December 31, 2039 (10 to 20 years)	3,273,805
Due January 1, 2040 or after (20 years or more)	<u>2,472,347</u>
Total investment in available-for-sale securities	\$ <u>5,897,040</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	\$ 3,105,506
Plus: Assessments	687,075
Plus: Interest	181,442
Plus: Miscellaneous Other Billings	94,170
Less: Collections/Write offs	(967,586)
Less: Adjustments	<u>(7,979)</u>
Balance, end of year	\$ <u>3,092,628</u>

The annual fee for 2019 was \$515 for single family lots (\$515 in 2018) and \$645 for multi-family lots (\$645 in 2018).

WIA established an allowance for uncollectible accounts for delinquent assessments in 2008. The net accounts receivable at December 31, 2019 is shown below:

Accounts receivable	\$ 3,092,628
Less: Allowance for bad debts	<u>(2,742,171)</u>
Net accounts receivable	\$ <u>350,457</u>

This account is reviewed annually by WIA. The Bad Debt expense for 2019 was \$482,653. Beginning in 2018, WIA adjusts 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 amount at December 31, 2019, that is uncollected for 2019 annual charges that were billed.

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, 2019, 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 – LAND AND PROPERTY AND EQUIPMENT

Land and property and equipment consists of the following categories:

<u>Cost</u>	
Land	\$1,318,329
Vehicles	49,563
Equipment	28,767
Buildings & Improvements	<u>926,593</u>
Total Property and Equipment	2,323,252
Less: Accumulated depreciation	<u>(512,058)</u>
Net cost	<u>\$1,811,194</u>

Land consists primarily of parkways, public areas (i.e. dump site), acreage, and 165 lots owned by WIA and is valued at \$1,318,329, 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 roads within Waterwood.

NOTE F – 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 G – 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 H – EMS (EMERGENCY MEDICAL SERVICES)

WIA's contract with Allegiance Ambulance was 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. The contract was renewed for two years, from January 1, 2020 to December 31, 2021, at the same contract amount per year.

NOTE I – 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 J – COMMITMENTS UNDER NONCAPITALIZED LEASES

WIA does not have any noncapitalized Leases

NOTE K – RELATED PARTY TRANSACTIONS

No related party transactions were noted during 2019.

NOTE L – SUBSEQUENT EVENTS

The Association had no reportable subsequent events through May 29, 2020, 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, 2019.

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, 2019 on page 14 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 15 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,

Davis, Heinemann + Co.

Davis, Heinemann & Company, P.C.
May 29, 2020

Waterwood Improvement Association, Inc.
Schedule of Operating Fund Revenues and Expenses - Budget and Actual - Budgetary Basis
For the Year Ended December 31, 2019

	Budget	Actual	Variance Favorable (Unfavorable)
REVENUES			
Annual charges	\$ 442,900	\$ 687,075	\$ 244,175
Interest on delinquent annual charges	-	181,442	181,442
Recoveries	25,000	31,091	6,091
Investment income	222,444	249,902	27,458
Sign rentals	3,000	2,750	(250)
Capital improvement charges	5,000	43,000	38,000
Property transfer fees	7,000	5,700	(1,300)
Fireworks donations	4,000	2,755	(1,245)
Trailer park maintenace & operating fee	2,520	2,400	(120)
Pool pass maintenace & operating fee	8,250	7,800	(450)
WWP lot sales	-	25,954	25,954
Other income	-	41	41
Gain/(loss) on sale of assets	-	1,000	1,000
Total Revenues	<u>720,114</u>	<u>1,240,910</u>	<u>520,796</u>
BUDGETED EXPENSES			
Vehicle expense	4,186	8,599	(4,413)
Repairs and maintenance	6,199	3,208	2,991
Licenses and fees	1,545	843	702
Community events	7,491	5,504	1,987
EMS contract	96,253	96,253	-
Insurance	39,267	36,644	2,623
Interest Expense	-	-	-
Grounds maintenance contract and landscaping	113,200	110,023	3,177
Miscellaneous	3,787	2,788	999
Office expense	15,568	20,098	(4,530)
Salaries and payroll tax	148,666	210,473	(61,807)
Professional fees	20,750	29,662	(8,912)
Pool maintainance	8,240	8,514	(274)
Road repair and maintenance	65,000	58,820	6,180
Golf course maintenance	45,000	44,490	510
Property taxes	5,150	3,349	1,801
Travel and meals	100	-	100
Utilities and services	77,588	73,096	4,492
Waterwood Volunteer Fire Department	500	518	(18)
Collection expense	-	-	-
Contract labor	7,695	7,442	253
Total Budgeted Expenses	<u>666,185</u>	<u>720,324</u>	<u>(54,139)</u>
Excess (Deficiency) Revenues Over (Under) Budgeted Expenses	<u>53,929</u>	<u>520,586</u>	<u>466,657</u>
NON-CASH AND NON-BUDGETED REVENUES/(EXPENSES)			
Unrealized gain/(loss) on securities	-	214,678	214,678
Depreciation expense	-	(45,991)	(45,991)
Bad debts	-	(482,653)	(482,653)
Bond premium/discount amortization	-	(16,414)	(16,414)
Total Non-Cash and Non-Budgeted Expenses	<u>-</u>	<u>(330,380)</u>	<u>(330,380)</u>
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENSES	<u>\$ 53,929</u>	<u>\$ 190,206</u>	<u>\$ 136,277</u>

WATERWOOD IMPROVEMENT ASSOCIATION, INC.
SUPPLEMENTARY INFORMATION ON FUTURE MAJOR REPAIRS AND
REPLACEMENTS (COMPILED)
For the Year Ended December 31, 2019

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.