

**PADRE ISLES PROPERTY OWNERS  
ASSOCIATION, INC.**

**ANNUAL AUDITED FINANCIAL REPORT**

For the year ended  
December 31, 2018

**JENNINGS, HAWLEY & CO., P.C.**  
CERTIFIED PUBLIC ACCOUNTANTS

**- I N D E X -**

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**Independent Auditor's Report**

To the Board of Directors  
Padre Isles Property Owners Association, Inc.

We have audited the accompanying financial statements of Padre Isles Property Owners Association, Inc. (a Texas nonprofit corporation), which comprise the balance sheet as of December 31, 2018, and the related statement of operations, and changes in fund balance and cash flows for the year then ended, and the related notes to the financial statements.

***Management's Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

***Auditor's Responsibility***

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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 Padre Isles Property Owners Association, Inc. as of December 31, 2018, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

### ***Omission of Required Supplementary Information about Future Major Repairs and Replacements***

Management has omitted the required supplemental information on future major repairs and replacements that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not part of the basic financial statements, is required by the Financial Accounting Standards Board, which considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. Our opinion on the basic financial statements is not affected by this missing information.

A handwritten signature in cursive script that reads "Jennings, Hawley & Co., P.C.".

Jennings, Hawley & Co., P.C.

Corpus Christi, Texas  
September 12, 2019

**PADRE ISLES PROPERTY OWNERS ASSOCIATION, INC.**  
**BALANCE SHEET**  
**DECEMBER 31, 2018**

Assets

|                                   |                            |
|-----------------------------------|----------------------------|
| Current assets:                   |                            |
| Cash and cash equivalents         | \$ 1,896,477               |
| Assessments receivable - owners   | 415,616                    |
| Allowance for doubtful accounts   | (199,166)                  |
| Prepaid expenses                  | 12,750                     |
| Total current assets              | <u>2,125,677</u>           |
| Property, plant and equipment     |                            |
| Office building                   | 102,167                    |
| Furniture and equipment           | 46,544                     |
|                                   | <u>148,711</u>             |
| Less accumulated depreciation     | (141,818)                  |
| Net property, plant and equipment | <u>6,893</u>               |
| Other assets:                     |                            |
| Investments                       | 7,639,418                  |
| Total other assets                | <u>7,639,418</u>           |
| Total assets                      | <u><u>\$ 9,771,988</u></u> |

Liabilities and Fund Balance

|  |                            |
|--|----------------------------|
| Current liabilities:                           |                            |
| Accounts payable                               | \$ 6,366                   |
| Builder deposits                               | 86,085                     |
| Payroll taxes payable                          | 601                        |
| Total current liabilities                      | <u>93,052</u>              |
| Fund balance - Operations without restrictions | <u>9,678,936</u>           |
| Total liabilities and fund balance             | <u><u>\$ 9,771,988</u></u> |

See independent auditor's report and the notes to the financial statements.

**PADRE ISLES PROPERTY OWNERS ASSOCIATION, INC.**  
**STATEMENT OF OPERATIONS**  
**FOR THE YEAR ENDED DECEMBER 31, 2018**

|   |                          |
|---|--------------------------|
| Revenues                                      |                          |
| Assessments                                   | \$ 1,818,805             |
| Architectural control committee fees          | 107,247                  |
| Investment income                             | 225,114                  |
| Interest on assessments in arrears            | 21,918                   |
| Realized/unrealized gain (loss) on securities | (222,545)                |
| Other income                                  | <u>5,872</u>             |
| Total revenues                                | <u>1,956,411</u>         |
| Expenses                                      |                          |
| Area maintenance and compliance               |                          |
| Bulkhead maintenance                          | 468,638                  |
| Canal maintenance                             | 7,341                    |
| Common area maintenance                       | 145,876                  |
| Architectural control committee compliance    | 12,431                   |
| Water inspections and quality improvements    | 47,225                   |
| Salaries-maintenance and compliance           | 61,768                   |
| Taxes-maintenance and compliance payroll      | <u>5,127</u>             |
| Total area maintenance and compliance         | 748,406                  |
| General and Operating expenses                | <u>796,032</u>           |
| Total expenses                                | <u>1,544,438</u>         |
| Excess of revenues over expenses              | <u><u>\$ 411,973</u></u> |

See independent auditor's report and the notes to the financial statements.

**PADRE ISLES PROPERTY OWNERS ASSOCIATION, INC.**  
**STATEMENT OF CHANGES IN FUND BALANCES**  
**FOR THE YEAR ENDED DECEMBER 31, 2018**

|                                  |                            |
|----------------------------------|----------------------------|
| Fund balance, December 31, 2017  | \$ 9,266,963               |
| Excess of revenues over expenses | <u>411,973</u>             |
| Fund balance, December 31, 2018  | <u><u>\$ 9,678,936</u></u> |

See independent auditor's report and the notes to the financial statements.

**PADRE ISLES PROPERTY OWNERS ASSOCIATION, INC.**  
**STATEMENT OF CASH FLOWS**  
**FOR THE YEAR ENDED DECEMBER 31, 2018**

|   |                     |
|---|---------------------|
| Cash flows form operating activities:   |                     |
| Excess of revenues over expenses  | \$ 411,973          |
| Adjustments to reconcile excess of revenues over expenses<br>to net cash provided (used) by operating activities: |                     |
| Depreciation  | 1,295               |
| Realized/Unrealized (Gain) loss on securities   | 222,545             |
| (Increase) decrease in:   |                     |
| Assessments receivable - owners, net  | (84,247)            |
| Prepaid expenses  | (142)               |
| Increase (decrease) in:   |                     |
| Accounts payable  | (157,919)           |
| Builder deposits  | 29,730              |
| Payroll taxes payable   | 446                 |
| Net cash provided by operating activities   | <u>423,681</u>      |
| Cash flows from investing activities:   |                     |
| Proceeds from sales of investments  | 3,350,270           |
| Purchases of investments  | (4,628,432)         |
| Purchases of furniture & equipment  | (3,786)             |
| Net cash used by investing activities   | <u>(1,281,948)</u>  |
| Net increase (decrease) in cash and cash equivalents  | (858,267)           |
| Cash and cash equivalents at beginning of year  | <u>2,754,744</u>    |
| Cash and cash equivalents at end of year  | <u>\$ 1,896,477</u> |

See independent auditor's report and the notes to the financial statements.



**PADRE ISLES PROPERTY OWNERS ASSOCIATION, INC.**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**DECEMBER 31, 2018**

(1) Nature or Organization

Padre Isles Property Owners Association, Inc. (the Association) is a non-profit membership association incorporated in the state of Texas on March 1, 1976 organized for the promotion of social welfare for residents of Padre Island-Corpus Christi subdivisions located in Nueces County, Texas. The association is responsible for the operation and maintenance of the common property of Padre Island-Corpus Christi development which consists of approximately 5,193 total lots consisting of approximately 4,430 residential units, 723 multi-family units, 17 seawall units, and 23 commercial units. Common property consists primarily of the association office, canals, certain bulkheads, boat ramps, and canal ends.

(2) Date of Management's Review

In preparing the financial statements, the Association has evaluated events and transactions for potential recognition or disclosure through September 12, 2019, the date the financial statements were available to be issued.

(3) Summary of Significant Accounting Policies

(a) Basis of Accounting

The accompanying financial statements have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. Revenues are recognized as earned and expenses are recognized when incurred.

(b) Cash and Cash Equivalents

For the purpose of the statement of cash flows, the Association considers all deposits in banks and highly liquid investments with original maturity of three months or less to be cash equivalents.

(c) Financial Statement Presentation

Padre Isles Property Owners Association, Inc. adopted FASB ASU No. 2016-14 (Topic 958). Under FASB ASU 2016-14, the Association is required to report information regarding its financial position and activities according to two classes: with restriction and without restrictions.

(d) Income Taxes

The Association's policy is to record interest and penalties related to income tax in operating expenses. For the year ended December 31, 2018 no interest or penalties were paid or accrued.

**PADRE ISLES PROPERTY OWNERS ASSOCIATION, INC.**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**DECEMBER 31, 2018**

(3) Summary of Significant Accounting Policies – Continued

(e) Recently Issued Accounting Standards

The following is an accounting pronouncement recently issued by the FASB:

In August 2016, the FASB issued ASU No. 2016-14, Not-for-Profit (NFP) entities (Topic 958): Presentation of Financial Statements for Not-for-Profit Entities, which changes the current guidance for assets classifications, governing board designations, investment return, underwater endowment funds, expenses, liquidity and presentation of operating cash flows. ASU 2016-14 reduces the required number of classes of net assets from three to two: net assets with donor restrictions and net assets without donor restrictions. ASU 2016-14 also requires not-for-profit entities to provide enhanced disclosures about the amounts and purposes of governing board designations and appropriations. ASU 2016-14 requires not-for-profits to report investment return net of external and direct internal investment expenses. The requirement to disclose those netted expenses is eliminated. In addition to the current required disclosure of the aggregate amount by which endowment funds are underwater, ASU 2016-14 requires not-for-profit entities to disclose the aggregate fair value of such funds as well as the aggregate original gift amounts to be maintained. ASU 2016-14 also requires a NFP to disclose its interpretation of the ability to spend from underwater endowment funds including its policy, and any actions taken during the period, concerning appropriation from underwater endowment funds. All underwater endowment funds will be classified as part of net assets with donor restrictions rather than as a change to unrestricted net assets as per the current rules. In the absence of explicit donor restrictions, ASU 2016-14 requires NFP entities to use the placed-in-service approach to account for capital gifts. The current option to use the over-time approach has been eliminated. ASU 2016-14 requires expenses to be reported by nature in addition to function and include an analysis of expenses by both nature and function. The methods used by NFP entities to allocate costs among program and support functions will also need to be disclosed. ASU 2016-14 requires NFP entities to provide both qualitative and quantitative information on management of liquid available resources and the ability to cover short-term cash needs within one year of the balance sheet date. Finally, current standards allow NFP entities to decide whether to present operating cash flows using either the direct method or the indirect method. ASU 2016-14 eliminates the requirement to present or disclose the indirect method of reconciliation if the entity decides to use the direct method. ASU 2016-14 is effective for annual reporting periods beginning after December 15, 2017. Early adoption is permitted with retrospective application required for all prior periods presented.

**PADRE ISLES PROPERTY OWNERS ASSOCIATION, INC.**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**DECEMBER 31, 2018**

(3) Summary of Significant Accounting Policies – Continued

(f) Assessments Receivable - Owners

Association members are subject to annual assessments to provide funds for the Association's operating and maintenance expenses. Assessments receivable-owners at December 31, 2018 represent assessment fees and other additional fees due from these members.

The allowance for doubtful accounts is based on management's assessment of collectability of specific accounts, the existing economic conditions, the age of the receivable, and the financial stability of the members. Accounts are charged to operations when they are deemed uncollectible. The allowance for doubtful accounts for the year ended December 31, 2018 was \$199,166.

(g) Concentration of Credit Risk

The Association maintains cash balances at four financial institutions located in south Texas. Accounts at each institution are insured by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000. Further, investment accounts are covered by Securities Investor Protection Corporation (SPIC) and/or by third party insurance companies. At December 31, 2018, the Association had \$50,203 of uninsured cash balances.

The majority of the Association's accounts receivable and revenue is centralized with the South Texas property owners.

(h) Property, Plant, and Equipment

Additions of new equipment and major renewals or replacements of existing equipment are capitalized at cost. Repairs that do not materially increase values or extend useful lives are expensed. Cost and related accumulated depreciation of property sold or retired are removed from the books with the resulting gain or loss included in other income.

Depreciation is provided principally on the straight-line depreciation method over the estimated useful lives of the related assets, ranging from 5 to 39 years.

(i) Functional Expenses

The cost of providing various maintenance and compliance and other activities of the Association has been summarized on a functional basis in the statement of operations. Accordingly, the basis used to record expenses is directly related to the type of expense as determined by management.

**PADRE ISLES PROPERTY OWNERS ASSOCIATION, INC.**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**DECEMBER 31, 2018**

(3) Summary of Significant Accounting Policies – Continued

(j) Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(k) Fund Accounting

The accounts of the Association are maintained in accordance with the principles of fund accounting. Under fund accounting, resources for various purposes are classified for accounting and reporting purposes into funds that are in accordance with specified activities or objectives. The Association has only one fund which, includes both Operating funds and Replacement funds.

(l) Fair Value Measurements and Investment Securities

The Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) section 820, “*Fair Value Measurement*,” defines fair value as the price that would be received upon sale of an asset or paid upon transfer of a liability in an orderly transaction between market participants at the measurement date and in the principal or most advantageous market for that asset or liability. The fair value should be calculated based upon assumptions that market participants would use in pricing the asset or liability, not on assumptions specific to the entity.

ASC 820 specifies a hierarchy of valuation techniques based upon whether the inputs to those valuation techniques reflect assumptions other market participants would use based upon market data obtained from independent sources (observable inputs). In accordance with ASC 820, the following summarizes the fair value hierarchy:

Level 1 Inputs – Unadjusted quoted market prices for identical assets and liabilities in an active market that the Association has the ability to access.

Level 2 Inputs – Inputs other than the quoted prices in active markets that are observable either directly or indirectly.

Level 3 Inputs – Inputs based on prices or valuation techniques that are both unobservable and significant to the overall fair value measurements.

**PADRE ISLES PROPERTY OWNERS ASSOCIATION, INC.**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**DECEMBER 31, 2018**

(3) Summary of Significant Accounting Policies – Continued

(l) Fair Value Measurements and Investment Securities - Continued

The Association uses fair value measurements to record fair value adjustments to certain assets and liabilities to determine fair value disclosures. At December 31, 2018, all investments were valued using Level 1 inputs.

ASC 820 requires the use of observable market data, when available, in making fair value measurements. When inputs used to measure fair value fall within different levels of the hierarchy, the level within which the fair value measurement is categorized is based on the lowest level input that is significant to the fair value measurements. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs. Cash and cash equivalents, accounts receivable, prepaid expenses, and accounts payable approximate their fair values due to the short-term nature of these financial instruments.

Investments in marketable equity securities with readily determinable fair values are valued at their fair values on the balance sheet. Unrealized gains and losses are included in the statement of operations. The securities are held in custodial investment brokerage accounts. Investments are made according to the investment objectives and policies adopted by the Association's Board. These guidelines provide for investment in equities and bond and fixed income securities allocated between target asset allocations to provide diversification in the investment portfolios. The asset allocation target is 40% for equity securities (target range of 35% to 45%) and 60% for bond and fixed income securities (target range of 55% to 65%).

The Association's investments are concentrated primarily in publicly traded equity and fixed income securities. Consequently, the value of the investment portfolio is subject to fluctuations resulting from market volatility. The Association has partially mitigated this risk by monitoring the asset allocation targets and diversification among the investments.

(4) Related Party Transactions

During 2018, the Association paid no payments to related party individuals or entities. While others may have also been paid for the same type of work or products, due to the relationship with the Association, a disclosure is required if any such related party transactions exist.

**PADRE ISLES PROPERTY OWNERS ASSOCIATION, INC.**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**DECEMBER 31, 2018**

(5) Supplemental Cash Flow Information

The Association made no payments for interest or income tax for the year ended December 31, 2018.

(6) Investments

Investments are recorded at fair value, all investments were valued using Level 1 inputs. The historical cost and fair value at December 31, 2018 are as follows:

| <u>Description</u>                   | <u>Level 1<br/>Fair Value</u> | <u>Unrealized<br/>Gain (Loss)</u> | <u>Cost</u>         |
|--------------------------------------|-------------------------------|-----------------------------------|---------------------|
| Long-Term Certificates<br>of Deposit | \$ 5,001,366                  | (\$ 2,066)                        | \$ 5,003,432        |
| Mutual Funds                         | <u>\$ 2,638,052</u>           | <u>\$ 164,340</u>                 | <u>\$ 2,473,712</u> |
| Total Investments                    | <u>\$ 7,639,418</u>           | <u>\$ 162,274</u>                 | <u>\$ 7,477,144</u> |

The beginning of the year unrealized gain (loss) on investments totaled \$384,819. The change in net unrealized gain (loss) on investments reported on the statement of operations for the year ended December 31, 2018 was (\$222,545).

(7) Liquidity and Availability of Funds

The Association financial assets available for general expenditures, that is without restrictions limiting their use, within one year of the balance sheet date, are as follows:

|   | <u>2018</u>         |
|---|---------------------|
| Cash and cash equivalents   | \$ 1,896,477        |
| Accounts receivable-owners, net of allowance  | <u>\$ 216,450</u>   |
| Total financial assets available to meet general expenditures<br>within the next 12 months. | <u>\$ 2,112,927</u> |

None of the financial assets are subject to restrictions that make them unavailable for general expenditure within one year of the balance sheet date. The accounts receivable are subject to implied time restrictions but are expected to be collected within one year. The Association sets goals of having financial assets on hand to meet six months of normal operating expense and emergency and necessary repairs, which are, on average \$915,501. As part of its liquidity management, the Association has a policy to structure its financial assets to be available as general expenditures, liabilities, and other obligations become due.



**PADRE ISLES PROPERTY OWNERS ASSOCIATION, INC.**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**DECEMBER 31, 2018**

(8) Income Taxes

The Association qualifies as tax-exempt under the Internal Revenue Code section 501(c)(4). Under that section, the Association is not taxed on income and expenses related to its exempt purpose.

Accounting principles generally accepted in the United States of America require management to evaluate tax positions taken by the Association and recognize a tax liability if the Association has taken an uncertain position that more likely than not would not be sustained upon examination by the IRS. Management has analyzed the tax positions taken by the Association and has concluded that as of December 31, 2018, there are no uncertain positions taken or expected to be taken that would require recognition of a liability or disclosure in the financial statements. The Association is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress. The Association's management believes it is no longer subject to income tax examinations for years prior to 2015. As of the date of this report, the Association's 2018 return has not been filed.

(9) Obligations Under Operating Leases

The Association leases office equipment and services with an expense of \$8,372 for the year ended December 31, 2018. Future minimum lease payments over the remaining years under these operating leases with noncancelable terms in excess of one year are as follows:

|       | Future<br>Minimum<br>Rentals |
|-------|------------------------------|
| 2019  | \$ 6,093                     |
| 2020  | 5,168                        |
| 2021  | 3,550                        |
| 2022  | 0                            |
| 2023  | 0                            |
| Total | <u>\$14,811</u>              |

(10) Commitments and Contingencies

In July 2019, an attorney for two member owners made a demand on the Association related to the alleged wrongful acts of the Association's Architectural Control Committee and Board with regard to a variance granted to a neighboring property owner who thereafter constructed a home and dock in violation of the Association's restrictions and covenants. The attorney for the two members has represented that it is unclear how the members intend to proceed. No specific demand for relief has been made. The Association denies any wrongdoing. No accrual has been made for this claim.

**PADRE ISLES PROPERTY OWNERS ASSOCIATION, INC.**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**DECEMBER 31, 2018**

(10) Commitments and Contingencies - Continued

The Association's Board has determined that a commercial storm insurance policy is cost-prohibitive and has opted to self-insure for emergency repairs. The Operations Fund would be used for future emergency repairs.

(11) Future Major Repairs and Replacements

The Association's governing documents do not require funds to be accumulated for future major repairs and replacements. The Association has not conducted a study to determine the remaining useful lives of the major components of common property and to estimate the costs of major repairs and replacements that may be required in the future. When additional funds are needed, the Association may increase maintenance assessments, or it may delay major repairs and replacements until funds are available. The effect on future assessments has not been determined.



**PADRE ISLES PROPERTY OWNERS ASSOCIATION, INC.**  
**SUPPLEMENTARY SCHEDULE OF OPERATING AND GENERAL EXPENSES**  
**FOR THE YEAR ENDED DECEMBER 31, 2018**

|   | Operating and<br>general expenses |
|---|-----------------------------------|
| Accounting Fees                               | \$ 28,836                         |
| Balloting, Newsletters and Postage            | 29,933                            |
| Depreciation                                  | 1,295                             |
| Insurance                                     | 67,275                            |
| Investment Fees                               | 6,445                             |
| Legal Fees                                    | 39,203                            |
| Office Expense                                | 13,117                            |
| Office Machine Rentals                        | 8,373                             |
| Placement services                            | 26,600                            |
| Repairs and Maintenance- Building and General | 369,106                           |
| Salaries-Administrative                       | 140,814                           |
| Taxes-Administrative Payroll                  | 11,267                            |
| Taxes-Property                                | 5,054                             |
| Telephone and Utilities                       | 13,810                            |
| Miscellaneous and Other Expenses              | 34,904                            |
|   | <hr/>                             |
| Total Operating and General Expenses          | \$ 796,032                        |
|   | <hr/> <hr/>                       |

See independent auditor's report and the notes to the financial statements.