PADRE ISLES PROPERTY OWNERS ASSOCIATION, INC.

Corpus Christi, Texas

<u>AUDITED FINANCIAL STATEMENTS</u>
December 31, 2015

KIRK, MONROE & KLOSTERMANN, L.L.P.
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INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying financial statements of Padre Isles Property Owners Association, Inc., which comprise the balance sheet as of December 31, 2015, and the related statements of operations, changes in fund balances, 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 of 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 Owners Association, Inc. as of December 31, 2015, 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.

(Continued on next page)

INDEPENDENT AUDITOR'S REPORT - Continuation

Report on Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The supplementary information is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of the Association's management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Other Matter

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 a part of the basic financial statements, is required by the Financial Accounting Standards Board, who 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 the missing information.

Kirk, Monroe & Klostermann, L.L.P.

Corpus Christi, Texas
February 16, 2016

PADRE ISLES PROPERTY OWNERS ASSOCIATION, INC.

BALANCE SHEET
DECEMBER 31, 2015

ASSETS					
Current Assets:					
Cash and Cash Equivalents	$	2,691,771.03	245.10?		
Assessments Receivable-Owners, Net of Allowance		175,707.67			
Prepaid Expenses and Other Receivables		5,220.10			
Total Current Assets				$	2,872,698.80
Property and Equipment, Net (Note 3)					9,102.41
Other Assets:					
Investments (Note 4)					5,734,332.59
TOTAL ASSETS				**$**	**8,616,133.80**
LIABILITIES AND FUND BALANCE					
Current Liabilities:					
Deposits for Builder Clean-up	$	64,300.00			
Accounts Payable		24,754.53			
Prepaid Owner Assessments		8,211.17			
Payroll Taxes Payable		6,870.74			
Total Current Liabilities				$	104,136.44
Fund Balance:					
Unrestricted Fund-Operations and Self-Insurance		8,511,997.36			
Total Fund Balance					8,511,997.36
TOTAL LIABILITIES AND FUND BALANCE				**$**	**8,616,133.80**

See Independent Auditor's Report and Notes to the Financial Statements.

PADRE ISLES PROPERTY OWNERS ASSOCIATION, INC.

STATEMENT OF OPERATIONS
FOR THE YEAR ENDED DECEMBER 31, 2015

		Unrestricted		
Revenues:				
Assessment Fees	$	1,636,532.59		
Architectural Control Committee Fees				
Resale Certificates, and Decals		78,901.28		
Investment Income		177,835.91		
Interest on Assessments in Arrears		17,220.42		
Realized Gain (Loss) on Securities		134,312.73		
Unrealized Gain (Loss) on Securities (Note 4)		(406,864.53)		
Miscellaneous		2,188.93		
Total Revenues			**$**	**1,640,127.33**
Expenses:				
Bulkhead Maintenance	$	422,983.00		
Canal Maintenance		83,043.58		
Common Area Maintenance		370,514.46		
Architectural Control Committee Compliance		14,806.97		
Insurance		48,207.59		
Beautification Expenses		1,409.90		
Water Inspections and Quality Improvements		51,632.30		
Operating and General Expenses		357,920.91		
Total Expenses				**1,350,518.71**
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENSES			**$**	**289,608.62**

PADRE ISLES PROPERTY OWNERS ASSOCIATION, INC.

STATEMENTS OF CHANGES IN FUND BALANCES
FOR THE YEAR ENDED DECEMBER 31, 2015

Fund Balances, December 31, 2014	**$**	**8,222,388.74**
Excess (Deficiency) of Revenues Over Expenses		289,608.62
Fund Balance, December 31, 2015	**$**	**8,511,997.36**

See Independent Auditor's Report and Notes to the Financial Statements.

PADRE ISLES PROPERTY OWNERS ASSOCIATION, INC.

STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2015

Cash Flows from Operating Activities		
Excess (Deficiency) of Revenues over Expenses	**$ 289,608.62**	
Adjustments to Reconcile Excess (Deficiency) of Revenues over Expenses to Net Cash Provided (Used) by Operating Activities:		
Depreciation	3,613.98	
Realized (Gain) Loss on Securities	(134,312.73)	
Unrealized (Gain) Loss on Securities	406,864.53	
(Increase) Decrease in:		
Assessments Receivable-Owners	18,497.75	
Prepaid Expenses	(549.80)	
Increase (Decrease) in:		
Deposits for Builder Clean-up	9,200.00	
Accounts Payable	14,571.21	
Prepaid Owner Assessments	(2,522.21)	
Payroll Taxes Payable and Other	1,191.08	
Net Cash Provided (Used) by Operating Activities		606,162.43
Cash Flows from Investing Activities		
Purchase of Fixed Assets	(4,992.30)	
Proceeds from Sales of Investments	1,407,765.82	
Purchases of Investments	(1,646,650.10)	
Net Cash Provided (Used) by Investing Activities		(243,876.58)
Cash Flows from Financing Activities		-
Net Increase (Decrease) in Cash		**362,285.85**
Cash at Beginning of Year		2,329,485.18
Cash at End of Year		**$ 2,691,771.03**

PADRE ISLES PROPERTY OWNERS ASSOCIATION, INC.

NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2015

Note 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

Padre Isles Property Owners Association, Inc. (the Association) is a non-profit Texas membership corporation, organized on March 1, 1976, organized exclusively 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 canals, bulkheads, boat ramps, canal ends, medians and cul-de-sacs.

Date of Management's Review

In preparing the financial statements, the Association has evaluated events and transactions for potential recognition or disclosure through February 16, 2016, the date that the financial statements were available to be issued.

Basis of Accounting

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

Fund Balance Classification

Statement of Financial Accounting Standards (SFAS) No. 117, *Financial Statements of Not-for-Profit Organizations* requires the Association to report information regarding its financial position and activities according to three classes of fund balances: unrestricted, temporarily restricted, and permanently restricted. Of the three classes of fund balances, the Association has only unrestricted net assets as of December 31, 2015. The financial statements report activities in unrestricted fund balances for the year ended December 31, 2015; there were no temporarily restricted or permanently restricted fund balance activities or fund balances for the year.

Note 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

Federal Income Tax Accounting

The Association is exempt from federal income tax under section 501(c)(4) of the Internal Revenue Code. As such, all income of the Association, other than unrelated business income, is tax exempt. The federal income tax returns of the Association for the years ended December 31, 2015 2014, 2013 and 2012 are subject to examination by the IRS, generally for three years after they were filed. Penalties and interest are expensed as incurred if assessed by the IRS.

Financial Accounting Standards Board (FASB) Interpretation 48, *Accounting for Uncertainty in Income Taxes* FASB Accounting Standards Codification™ (ASC) 740 requires the Association to disclose its policy for evaluating uncertain tax positions. The Association evaluates its uncertain tax positions using the provisions of ASC 450, *Contingencies*. Accordingly, a loss contingency is recognized when it is probable that a liability has been incurred as of the date of the financial statements and the amount of the loss can be reasonably estimated. The amount recognized is subject to estimate and management judgment with respect to the likely outcome of each uncertain tax position. Management has evaluated all tax positions taken by the Association and has not recognized any liability as of the date of the financial statements. The amount that is ultimately sustained for an individual uncertain tax position or for all uncertain tax positions in the aggregate could differ from the amount recognized.

Concentrations of Credit Risk

The Association maintains cash balances at four financial institutions located in south Texas. Accounts at the institutions are insured by the Federal Deposit Insurance Corporation (FDIC) up to $250,000.00. Further, all investment accounts at brokerage firms are covered by Securities Investor Protection Corporation (SIPC) insurance up to $500,000.00. Excess SIPC protection has also been provided up to the full amount of the account values. SIPC insurance and excess SIPC insurance does not protect against changes in the market value of investments. As of December 31, 2015, the cash and cash equivalents amounts that exceeded the FDIC limits equaled $1,277,605.79.

Assessments Receivable

The owners of the development on Padre Island-Corpus Christi are subject to assessments to provide funds for the maintenance and operating expenses. Assessments Receivable-Owners at December 31, 2015 represent assessment fees and variable charges due from these owners.

Note 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)
Assessments Receivable - Continuation

Management reviews assessments receivable periodically and, if necessary, liens are filed on accounts considered to be delinquent. The provision for doubtful accounts is based on various factors including the age of the receivable, the local economy, the owner's ability to pay, and management's assessment. As of December 31, 2015, the allowance for doubtful accounts was $174,305.74.

Property and Equipment

Property and equipment acquired by the Association is recorded at cost and depreciated using the straight line method over the estimated useful lives of the items. Maintenance and repairs which do not improve or extend the life of the assets are expensed as incurred.

Statement of Cash Flows

For purposes of the Statement of Cash Flows, the Association considers short-term investments purchased with maturities of three months or less to be cash equivalents. Supplemental disclosures required for the statement of cash flows include $0.00 in interest expense paid and $0.00 in income taxes paid.

Investment Securities

Investments in marketable equity securities with readily determinable fair values are valued at their fair values in 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.

Note 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

Fair Value Measurement

On January 1, 2008, the Association adopted Statement of Financial Accounting Standard No. 157, *Fair Value Measurement* (SFAS 157), the Association has categorized its investments, based on the priority of the inputs to the valuation technique, into a three-level fair value hierarchy. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). If the inputs used to measure the financial instruments fall within different levels of the hierarchy, the categorization is based on the lowest level input that is significant to the fair value measurement of the instrument.

Financial assets and liabilities recorded on the balance sheet are categorized based on the inputs to the valuation techniques as follows:

Level 1
Financial assets and liabilities are valued using inputs that are unadjusted quoted prices in active markets accessible at the measurement date of identical financial assets and liabilities. The inputs include cash and cash equivalents, publicly traded equity securities, and government and corporate bonds that are traded by dealers or brokers in active over-the-counter markets.

Level 2
Financial assets and liabilities are valued using other observable inputs other than quoted prices in active markets. Real estate, commodities and mineral interests and other assets are generally valued using third party market appraisals.

Level 3
Financial assets and liabilities are valued upon unobservable inputs. Level 3 includes common stock which is not publicly held and is valued using historical gift value.

The Association uses fair value measurements to record fair value adjustments to certain assets and liabilities to determine fair value disclosures. At December 31, 2015, all investments were valued using Level 1 inputs.

PADRE ISLES PROPERTY OWNERS ASSOCIATION, INC.

NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2015

Note 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continuation)

Estimates

The preparation of financial statements in conformity with 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.

Note 2 - FUTURE 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.

Note 3 - PROPERTY AND EQUIPMENT

Property and equipment, depreciated using straight line methods over 3 to 15 years, at December 31, 2015 consisted of the following:

Office Building	$102,167.00
Office Equipment and Shed	41,622.94
Total	$143,789.94
Less Accumulated Depreciation	(134,687.53)
NET PROPERTY AND EQUIPMENT	**$ 9,102.41**

PADRE ISLES PROPERTY OWNERS ASSOCIATION, INC.

NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2015

Note 4 – INVESTMENTS

Investments at December 31, 2015 consisted of the following:

	Fair Value	Unrealized Gain (Loss)	Cost
Long-Term Certificates of Deposit	$ 1,748,827.75	($ 1,172.25)	$1,750,000.00
Open-end Mutual Funds	3,985,504.84	140,832.29	3,844,672.55
Total Investments	**$ 5,734,332.59**	**$ 139,660.04**	**$5,594,672.55**

The beginning of the year unrealized gain (loss) on investments equaled $546,524.57. As such, the income statement effect equaled $406,864.53 unrealized loss as reported in the statement of operations for the year ended December 31, 2015.

Note 5 – OBLIGATIONS UNDER OPERATING LEASES

The Association has entered into operating leases for some office equipment and services. Future minimum lease payments over the remaining years under these operating leases with noncancelable terms in excess of one year are as follows:

	Future Minimum Rentals
2016	$ 5,556.00
2017	4,020.00
2018	4,020.00
2019	2,345.00
Total	**$15,941.00**

Note 6 – COMMITMENTS AND CONTINGENCIES

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 and Self-Insurance fund can be used for future emergency repairs.

SUPPLEMENTARY

SCHEDULES

PADRE ISLES PROPERTY OWNERS ASSOCIATION, INC.

SUPPLEMENTARY SCHEDULE OF OPERATING AND GENERAL EXPENSES FOR THE YEAR ENDED DECEMBER 31, 2015

Accounting Fees	$ 5,213.54	
Audit Fees	8,925.00	
Legal Fees	15,839.88	
Other Professional Fees	5,168.00	
Investment Fees	6,000.00	
Balloting, Newsletters and Postage	22,379.39	
Depreciation	3,613.98	
Office Expense	13,177.16	
Office Machine Rentals	9,391.82	
Telephone and Utilities	12,709.74	
Repairs and Maintenance-Building and General	40,963.12	
Salaries-Administrative	149,357.98	
Taxes-Payroll	11,678.79	
Taxes-Property	5,462.37	
Bad Debt Expense	41,254.28	
Miscellaneous and Other Expenses	6,785.86	
Total Operating and General Expenses		**$ 357,920.91**

See Independent Auditor's Report.

PADRE ISLES PROPERTY OWNERS ASSOCIATION, INC.

SUPPLEMENTARY SCHEDULE OF COMPARATIVE BALANCE SHEETS
DECEMBER 31, 2015 AND 2014

		2015		2014
ASSETS				
Current Assets:				
Cash and Cash Equivalents	$	2,691,771.03	$	2,329,485.18
Assessments Receivable-Owners, Net of Allowance		175,707.67		194,205.42
Prepaid Expenses and Other Receivables		5,220.10		4,670.30
Total Current Assets		2,872,698.80		2,528,360.90
Property and Equipment, Net		9,102.41		7,724.09
Other Assets:				
Investments		5,734,332.59		5,768,000.11
TOTAL ASSETS	$	**8,616,133.80**	$	**8,304,085.10**
LIABILITIES AND FUND BALANCES				
Current Liabilities:				
Deposits for Builder Clean-up	$	64,300.00	$	55,100.00
Accounts Payable		24,754.53		10,183.32
Prepaid Owner Assessments		8,211.17		10,733.38
Payroll Taxes Payable		6,870.74		5,679.66
Total Current Liabilities		104,136.44		81,696.36
Fund Balance:				
Unrestricted Fund-Operations and Self-Insurance		8,511,997.36		8,222,388.74
Total Fund Balance		8,511,997.36		8,222,388.74
TOTAL LIABILITIES AND FUND BALANCES	$	**8,616,133.80**	$	**8,304,085.10**

See Independent Auditor's Report.

PADRE ISLES PROPERTY OWNERS ASSOCIATION, INC.

SUPPLEMENTARY SCHEDULE OF COMPARATIVE STATEMENTS OF OPERATIONS FOR THE YEARS ENDED DECEMBER 31, 2015 AND 2014

		Unrestricted		
		2015		2014
Revenues:				
Assessment Fees	$	1,636,532.59	$	1,575,168.60
Architectural Control Committee Fees				
Resale Certificates, and Decals		78,901.28		80,874.37
Investment Income		177,835.91		256,051.77
Interest on Assessments in Arrears		17,220.42		18,588.36
Realized Gain (Loss) on Sales of Securities		134,312.73		(10,943.88)
Unrealized Gain (Loss) on Securities		(406,864.53)		90,521.20
Miscellaneous and Decal Income		2,188.93		5,853.12
Total Revenues		**1,640,127.33**		**2,016,113.54**
Expenses:				
Bulkhead Maintenance		422,983.00		474,736.00
Canal Maintenance		83,043.58		58,978.61
Common Area Maintenance		370,514.46		218,764.50
Architectural Control Committee Compliance		14,806.97		14,139.14
Insurance		48,207.59		47,054.59
Beautification Expenses 4@ 1666	6664 -	1,409.90		20,000.00
Water Inspections and Quality Improvements		51,632.30		45,659.75
Operating and General Expenses		357,920.91		331,010.14
Total Expenses		**1,350,518.71**		**1,210,342.73**
EXCESS (DEFICIT) OF REVENUES OVER EXPENSES	$	**289,608.62**	$	**805,770.81**

PADRE ISLES PROPERTY OWNERS ASSOCIATION, INC.

SUPPLEMENTARY SCHEDULE OF COMPARATIVE OPERATING AND GENERAL EXPENSES FOR THE YEARS ENDED DECEMBER 31, 2015 AND 2014

	2015	2014
Accounting Fees	$ 5,213.54	$ 6,331.54
Audit Fees	8,925.00	8,650.00
Legal Fees	15,839.88	9,545.22
Other Professional Fees	5,168.00	23,100.00
Investment Fees	6,000.00	6,000.00
Balloting, Newsletters and Postage	22,379.39	17,435.43
Depreciation	3,613.98	3,019.68
Office Expense	13,177.16	14,130.34
Office Machine Rentals	9,391.82	6,811.29
Telephone and Utilities	12,709.74	12,599.94
Repairs and Maintenance-Building and General	40,963.12	33,469.64
Salaries-Administrative	149,357.98	142,618.84
Taxes-Payroll	11,678.79	11,174.05
Taxes-Property	5,462.37	5,066.05
Bad Debt Expense	41,254.28	26,650.28
Miscellaneous and Other Expenses	6,785.86	4,407.84
Total Operating and General Expenses	**$ 357,920.91**	**$ 331,010.14**

See Independent Auditor's Report.