

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

ANNUAL AUDITED FINANCIAL REPORT

For the year ended
December 31, 2017

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JENNINGS, HAWLEY & CO., P.C.

CERTIFIED PUBLIC ACCOUNTANTS

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., which comprise the balance sheet as of December 31, 2017, and the related statements of revenues, expenses, 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, 2017, 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.

Jennings, Hawley & Co., P.C.

Jennings, Hawley & Co., P.C.

Corpus Christi, Texas

December 7, 2018

PADRE ISLES PROPERTY OWNERS ASSOCIATION, INC.
BALANCE SHEET
DECEMBER 31, 2017

Assets

Current assets:

Cash and cash equivalents	\$ 2,754,744
Assessments receivable - owners	329,282
Allowance for doubtful accounts	(197,079)
Prepaid expenses	12,608
Total current assets	2,899,555

Property, plant and equipment

Office building	102,167
Furniture and equipment	42,757
	144,924
Less accumulated depreciation	(140,522)
Net property, plant and equipment	4,402

Other assets:

Investments	6,583,801
Total other assets	6,583,801

Total assets	\$ 9,487,758
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Liabilities and Fund Balance

Current liabilities:

Accounts payable	\$ 164,285
Builder deposits	56,355
Payroll taxes payable	155
Total current liabilities	220,795

Fund balance - Operations	9,266,963
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Total liabilities and fund balance	\$ 9,487,758
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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, 2017

Revenues	
Assessments	\$ 1,765,332
Architectural control committee fees	116,961
Investment income	168,260
Interest on assessments in arrears	22,940
Unrealized gain (loss) on securities	92,036
Other income	<u>99,409</u>
Total revenues	<u>2,264,938</u>
Expenses	
Bulkhead maintenance	641,521
Canal maintenance	76,278
Common area maintenance	451,460
Architectural control committee compliance	14,076
Insurance	59,497
Water inspections and quality improvements	47,321
Operating and general expenses	<u>827,412</u>
Total expenses	<u>2,117,565</u>
Excess of revenues over expenses	<u><u>\$ 147,373</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, 2017

Fund balance, December 31, 2016	\$ 9,119,590
Excess of revenues over expenses	<u>147,373</u>
Fund balance, December 31, 2017	<u><u>\$ 9,266,963</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, 2017

Cash flows form operating activities:	
Excess of revenues over expenses	\$ 147,373
Adjustments to reconcile excess of revenues over expenses to net cash provided (used) by operating activities:	
Depreciation	2,183
Unrealized (Gain) loss on securities	(92,036)
(Increase) decrease in:	
Assessments receivable - owners, net	78,239
Prepaid expenses	(7,633)
Increase (decrease) in:	
Accounts payable	124,443
Builder deposits	6,555
Payroll taxes payable	132
Net cash provided by operating activities	<u>259,256</u>
Cash flows from investing activities:	
Proceeds from sales of investments	3,148,723
Purchases of investments	<u>(3,275,270)</u>
Net cash used by investing activities	<u>(126,547)</u>
Net increase (decrease) in cash and cash equivalents	132,709
Cash and cash equivalents at beginning of year	<u>2,622,035</u>
Cash and cash equivalents at end of year	<u>\$ 2,754,744</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, 2017

(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, 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 December 7, 2018, 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) Basis of Presentation

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 operating fund is used to account for the financial resources available for the general operations of the Association. The Association reports information regarding its financial position and activities according to three classes: unrestricted, temporarily restricted, and permanently restricted. The Association has unrestricted fund balances only.

PADRE ISLES PROPERTY OWNERS ASSOCIATION, INC.
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2017

(3) Summary of Significant Accounting Policies – Continued

(d) 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, 2017 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, 2017 was \$197,079.

(e) 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, 2017 and 2016, the Association had no uninsured cash balances.

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

(f) 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 7 years.

PADRE ISLES PROPERTY OWNERS ASSOCIATION, INC.
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2017

(3) Summary of Significant Accounting Policies – Continued

(g) 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.

The Association uses fair value measurements to record fair value adjustments to certain assets and liabilities to determine fair value disclosures. At December 31, 2017, 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.

PADRE ISLES PROPERTY OWNERS ASSOCIATION, INC.
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2017

(3) Summary of Significant Accounting Policies – Continued

(g) Fair Value Measurements and Investment Securities - Continued

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.

(h) 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, 2017 no interest or penalties were paid or accrued.

(i) 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.

PADRE ISLES PROPERTY OWNERS ASSOCIATION, INC.
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2017

(4) Investments

Investments are recorded at fair value. The historical cost and fair value at December 31, 2017 are as follows:

<u>Description</u>	<u>Fair Value</u>	<u>Unrealized Gain (Loss)</u>	<u>Cost</u>
Long-Term Certificates of Deposit	\$ 3,720,537	(\$ 4,733)	\$ 3,725,270
Mutual Funds	<u>\$ 2,863,264</u>	<u>\$ 389,552</u>	<u>\$ 2,473,712</u>
Total Investments	<u>\$ 6,583,801</u>	<u>\$ 384,819</u>	<u>\$ 6,198,982</u>

The beginning of the year unrealized gain (loss) on investments totaled \$292,783. The change in net unrealized gain (loss) on investments reported on the statement of operations for the year ended December 31, 2017 was \$92,036.

(5) 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, 2017, 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.

(6) Supplemental Cash Flow Information

The Association made no payments for interest or income tax for the year ended December 31, 2017.

PADRE ISLES PROPERTY OWNERS ASSOCIATION, INC.
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2017

(7) Obligations Under Operating Leases

The Association leases office equipment and services with an expense of \$7,893 for the year ended December 31, 2017. 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 <u>Rentals</u>
2018	\$ 7,893
2019	7,893
2020	5,883
2021	3,550
2022	<u>0</u>
Total	<u>\$25,219</u>

(8) Related Party Transactions

During 2017, the Association paid some related party individuals and entities amounts for various services performed and products purchased. While others may have also been paid for the same type of work or products, due to the relationship with the Association, the required disclosures of related party transactions are detailed as follows.

Canal maintenance of \$76,278 includes payments of \$43,330 to an engineering firm that employs a board member. Common Area Maintenance of \$451,460 includes payments of \$9,124 to related parties of a former employee for services performed. Water inspections and quality improvements of \$47,321 include \$960 paid to a board member for reimbursements and \$444 for office expense reimbursements. Payments of \$1,237 were paid to a vendor of which a board member is part owner; these payments were comprised of \$1,161 for common area maintenance and \$76 for office expense which is reported within the operating and general expenses. A board member and a related party of another board member were reimbursed \$411 for office supplies. A related party to a former employee received payments of \$8,942 for accounting, ACC compliance, general maintenance, and common area maintenance.

(9) 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.
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2017

(10) 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 Fund would be used for future emergency repairs.

PADRE ISLES PROPERTY OWNERS ASSOCIATION, INC.
SUPPLEMENTARY SCHEDULE OF OPERATING AND GENERAL EXPENSES
FOR THE YEAR ENDED DECEMBER 31, 2017

Accounting Fees	\$ 19,062
Balloting, Newsletters and Postage	35,155
Depreciation	2,183
Investment Fees	6,000
Legal Fees	73,557
Office Expense	17,905
Office Machine Rentals	7,768
Recruitment fees	17,000
Repairs and Maintenance- Building and General	306,899
Salaries-Administrative	253,329
Taxes-Payroll	20,206
Taxes-Property	11,147
Telephone and Utilities	15,504
Miscellaneous and Other Expenses	<u>41,697</u>
Total Operating and General Expenses	<u><u>\$ 827,412</u></u>

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