

**DIAMONDHEAD  
PROPERTY OWNERS ASSOCIATION, INC.**

**Hot Springs, Arkansas**

**March 31, 2009**

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GARY D. WELCH, CPA, Principal  
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HARRY C. KEATON, CPA  
(1920-2006)

CLARENCE W. JORDAN, CPA  
Retired

Jordan • Woosley • Crone • Keaton • Ltd.

CERTIFIED PUBLIC ACCOUNTANTS

### Independent Auditors Report

Board of Directors  
Diamondhead Property Owners Association, Inc.  
Hot Springs, Arkansas

We have audited the accompanying balance sheet of Diamondhead Property Owners Association, Inc. as of March 31, 2009, and the related statements of revenue and expenses, membership equity and cash flows for the year then ended. These financial statements are the responsibility of the Association's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with United States generally accepted auditing standards. 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 includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Diamondhead Property Owners Association, Inc. as of March 31, 2009, and the results of its operations and its cash flows for the year then ended, in conformity with United States generally accepted accounting principles.

The supplementary information on future, major repairs and replacements is not a required part of the basic financial statements 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.

A handwritten signature in black ink that reads "Jordan, Woosley, Crone & Keaton Ltd." in a cursive style. Below the signature, the text "Certified Public Accountants" is printed in a simple, sans-serif font.

Certified Public Accountants

July 29, 2009

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MEMBERS  
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**Diamondhead Property Owners Association, Inc.**  
**BALANCE SHEET**  
**March 31, 2009**

ASSETS

Current Assets

Cash and cash equivalents		\$ 632,168
Certificates of deposit		538,514
Accounts receivable	\$ 539,172	
Less allowance for doubtful accounts	<u>419,878</u>	119,294
Accounts receivable - other		48,292
Inventory		10,952
Lot inventory		3,237
Prepaid expenses		30,719
Prepaid insurance		19,905
Utility deposits		<u>5,179</u>

Total Current Assets \$ 1,408,260

Fixed Assets

Land		\$ 80,530
Buildings	\$ 1,855,839	
Equipment	498,633	
Furniture and fixtures	6,910	
Roads and right-of-ways	<u>2,592,155</u>	
Total	<u>\$ 4,953,537</u>	
Less accumulated depreciation	<u>2,186,319</u>	2,767,218
Construction in progress		<u>73,445</u>

Net Fixed Assets 2,921,193

Total Assets

\$ 4,329,453

See independent auditors report and notes to financial statements.

**Diamondhead Property Owners Association, Inc.**  
**BALANCE SHEET**  
**March 31, 2009**

LIABILITIES AND MEMBERSHIP EQUITY

Current Liabilities

Accounts payable	\$	57,648
Accounts payable - committee fund		21,451
Notes payable – current installments		24,849
Unearned revenue		375,502
Property taxes payable		17,350
Refunds payable		2,605
Sales tax payable		2,446
Accrued expenses		11,360
Accrued vacation and wages		<u>32,530</u>

Total Current Liabilities		\$ 545,741
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Long-term Liabilities

Notes payable excluding current installments		<u>52,185</u>
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Total Liabilities		\$ 597,926
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Membership Equity

Undesignated	\$	3,710,763
Designated		<u>20,764</u>

Total Membership Equity		<u>3,731,527</u>
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<u>Total Liabilities and Membership Equity</u>		<u>\$ 4,329,453</u>
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See independent auditors report and notes to financial statements.

**Diamondhead Property Owners Association, Inc.**  
**STATEMENT OF REVENUE AND EXPENSES**  
**For the Year Ended March 31, 2009**

<u>Operating Revenue</u>		
General operating fees	\$ 1,273,905	
Golf course	304,384	
News and publicity	17,427	
Nineteenth Hole	91,207	
Pool	<u>13,979</u>	
Total Operating Revenue		\$ 1,700,902
 <u>Operating Expenses</u>		
Bad debts	\$ 100,506	
Depreciation	79,246	
General and administrative	250,755	
Golf course	441,702	
News and publicity	24,096	
Nineteenth Hole	123,320	
Police and fire	159,582	
Roads and general maintenance	65,283	
Swimming pool and tennis courts	<u>36,486</u>	
Total Operating Expenses		<u>1,280,976</u>
 <u>Net Operating Income</u>		 \$ 419,926
 <u>Other Income and [Deductions]</u>		
Gain on sale of fixed assets	\$ 108,628	
Gain on transfer of lot inventory	127,108	
Interest income	26,523	
Interest expense	<u>[ 7,861]</u>	
Net Other Income		<u>254,398</u>
 <u>Net Income to Membership Equity</u>		 <u>\$ 674,324</u>

See independent auditors report and notes to financial statements.

**Diamondhead Property Owners Association, Inc.**  
**STATEMENT OF MEMBERSHIP EQUITY**  
**For the Year Ended March 31, 2009**

	<u>Undesignated</u>	<u>Designated</u>	<u>Total</u>
<u>Membership Equity - April 1, 2008</u>	\$ 3,057,203		\$ 3,057,203
<u>Additions</u>			
Net income for the year ended March 31, 2009	674,324		674,324
Reclassify designated replacement equity	[ 20,764]	\$ 20,764	
<u>Balance - March 31, 2009</u>	<u>\$ 3,710,763</u>	<u>\$ 20,764</u>	<u>\$ 3,731,527</u>

See independent auditors report and notes to financial statements.

**Diamondhead Property Owners Association, Inc.**  
**STATEMENT OF CASH FLOWS**  
**For the Year Ended March 31, 2009**

<u>Cash Flows from Operating Activities</u>		
Cash received from members and other fees	\$ 1,445,143	
Cash paid to employees, suppliers and others	[1,093,548]	
Interest income	11,770	
Interest expense	<u>[ 7,861]</u>	
Net Cash Provided by Operating Activities		\$ 355,504
<u>Cash Flows from Investing Activities</u>		
Purchase of certificate of deposit	\$[ 101,919]	
Capital expenditures	[ 358,511]	
Proceeds from sale of fixed assets	<u>110,550</u>	
Net Cash Used in Investing Activities		[349,880]
<u>Cash Flows from Financing Activities</u>		
Principal payment on debt		<u>[ 23,229]</u>
<u>Net Decrease in Cash and Cash Equivalents</u>		\$[ 17,605]
<u>Cash and Cash Equivalents - April 1, 2008</u>		<u>649,773</u>
<u>Cash and Cash Equivalents - March 31, 2009</u>		<u>\$ 632,168</u>
Cash:		
Undesignated	\$ 589,953	
Designated	20,764	
Committee	<u>21,451</u>	
Total		<u>\$ 632,168</u>

Noncash investing activities consisted of \$14,753 in interest earned and retained in certificates of deposit and \$146,541 in capital assets conveyed (see Note 3).

See independent auditors report and notes to financial statements.

**Diamondhead Property Owners Association, Inc.**  
**NOTES TO FINANCIAL STATEMENTS**  
**March 31, 2009**

**NOTE 1: Summary of Significant Accounting Policies -**

Nature of Organization. Diamondhead Property Owners Association, Inc. was incorporated on September 18, 1969, as a not-for-profit organization in the State of Arkansas. The Association is responsible for the operation and maintenance of the common property in Diamondhead for the benefit of property owners. The Association also provides recreational services for its members and their guests.

Use of Estimates. The preparation of financial statements in conformity with United States 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.

Inventories. Inventories are stated at the lower of cost of market, first-in first-out method. Lot inventory consists of real estate lots reacquired by the Association and is stated at the cumulative-reacquisition-cost basis.

Fixed Assets and Depreciation. Fixed assets are valued at acquisition cost. Depreciation is computed on the straight-line method based on estimated useful lives of related assets for financial statement presentation.

Revenue Recognition. Financial records of the Association are maintained on a full-accrual basis. Gross income from membership assessments is recorded when earned, and expenses are recognized when incurred.

Member Assessments. Association members are subject to annual assessments to provide funds for the Association's operating expenses, future capital acquisitions and major repairs and replacements. Accounts receivable represent fees due from property owners. The accounts over four years old and any balances remaining after settlement are charged off as uncollectible. However, if assessments are due on a home, they are collectible when the home is sold.

Allowance for Doubtful Accounts. Assessments receivable are stated net of an allowance for doubtful accounts. Prior to the year ended March 31, 2009, the Association estimated the allowance by taking into consideration the age of past-due accounts and an assessment of the member's ability to pay. As a result of changes in the Association's credit policy during the year, the Association changed to estimating the allowance based on its historical experience of collections, actual bad debts and net credit sales. This change resulted in a \$115,399 increase in net income for the year ended March 31, 2009. The allowance for doubtful accounts was \$419,878 and \$352,877 at March 31, 2009 and 2008, respectively.

Income Taxes. As enacted by the 1976 Tax Reform Act, Section 528 of the Internal Revenue Code allows the Association to elect to be treated as a tax-exempt organization. The tax-exempt status only protects the Association from tax on its exempt-function income that includes membership dues. The Association is taxed at the rate of 30% on non-exempt function income such as interest and fees. However, a homeowners association that is a corporation may elect to be taxed as a regular corporation if the tax is less in comparison to the tax under Section 528 on non-exempt function income.

See independent auditors report.

**Diamondhead Property Owners Association, Inc.**  
**NOTES TO FINANCIAL STATEMENTS**  
(continued)  
**March 31, 2009**

Cash and Cash Equivalents. For purposes of the statement of cash flows, the Association considers all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents.

Reclassification. Certain amounts in the March 31, 2009 financial statements have been reclassified to conform to the March 31, 2009 presentation.

**NOTE 2: Cash and Cash Equivalents and Certificates of Deposit** – The Association's accounts with financial institutions are insured by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000 with additional collateralization from a repurchase agreement for \$538,179. At March 31, 2009, the Association's unreconciled cash balances totaled \$1,167,882, of which \$379,703 were in excess of FDIC insurance limits and pledged securities.

**NOTE 3: Account Receivable – Other** – During the year ended March 31, 2009, the Association sold all of its lot inventory to a developer in exchange for the developer building a new Association office building, making repairs to the pool and security grounds and supplying equipment in the new country club. The \$45,168 is included in accounts receivable – other on the balance sheet.

Cost of assets conveyed to the Association	\$ 146,541
Additional assets conveyed to the Association	45,168
Value of lots transferred	<u>[ 64,601]</u>
<u>Gain on Transfer of Lots</u>	<u>\$ 127,108</u>

**NOTE 4: Construction in Progress** – The Association's board entered into contractual obligations to build a country club where the 19<sup>th</sup> Hole restaurant and Association's office were. At March 31, 2009, the 19<sup>th</sup> Hole and Association office were set for demolition. The net book value of the building was \$20,382 and, as required by generally accepted accounting principles, is recorded as an increase to construction in progress. Subsequent to the year end, the demolition of the old 19<sup>th</sup> Hole and Association office was completed; and the construction of the new country club has started. The new country club will cost approximately \$850,000 and is expected to be completed during 2009. The Association will finance a substantial part of the construction with a local bank.

**NOTE 5: Notes Payable** - At March 31, 2009, the Association had a notes payable for capital leases on golf equipment as follows:

<u>Payable to</u>	<u>Maturity Date</u>	<u>Interest</u> Rate	<u>*Monthly</u> Payment	<u>Amount Due</u>		
				<u>Current</u>	<u>Long-term</u>	<u>Total</u>
National City	May 1, 2010	8.116%	\$ 342	\$ 3,880	\$ 678	\$ 4,558
Textron	February 15, 2010	5.225%	\$ 416	4,459		4,459
Textron	August 15, 2012	9.475%	\$ 2,749	16,510	51,507	68,017
				<u>\$ 24,849</u>	<u>\$ 52,185</u>	<u>\$ 77,034</u>

See independent auditors report.

**Diamondhead Property Owners Association, Inc.**  
**NOTES TO FINANCIAL STATEMENTS**  
(continued)  
**March 31, 2009**

Aggregate Debt Obligation Matures as Follows

<u>March 31,</u>	
2010	\$ 24,849
2011	18,822
2012	19,940
2013	<u>13,423</u>
Total	<u>\$ 77,034</u>

\*including interest

At March 31, 2009, the carrying amount (book value) of assets pledged as collateral on the above notes was \$74,937.

**NOTE 6: Lease Commitments** - In prior years, the Association entered into operating lease commitments for golf course mowers and golf carts. These operating leases record costs on a monthly lease basis; operating lease expense for the year ended March 31, 2009, was \$30,659. Future lease payments are as follows:

March 31, 2010	\$ 30,742
March 31, 2011	\$ 12,171
March 31, 2012	\$ 2,114

**NOTE 7: Future, Major Repairs and Replacements** - In August 1999, the Association's board of directors engaged an independent insurance agent to conduct a study to estimate the remaining, useful lives and the replacement costs of the common property components. Actual expenditures may vary from the estimated amounts and the variations may be material. When funds are needed for the cost of future, major repairs and replacements, the Association has the right to increase regular assessments, pass special assessments or delay major repairs and replacements until funds are available. The effect on future assessments has not been determined. Accumulated funds for future, major repairs and replacements, which totaled \$20,764 at March 31, 2009, are generally not available for operating purposes.

**NOTE 8: Sale of Country Club/Installment Sale and Deferred Gain** - On March 26, 2007, the Association sold the country club building, grounds, furniture and fixtures for a total of \$550,000 to Cooper Creek Development, LLC. Installments on the note receivable were due as follows:

March 26, 2007 (at closing)	\$ 220,000
April 2, 2007	220,000
April 2, 2008	<u>110,000</u>
<u>Total</u>	<u>\$ 550,000</u>

The last installment is recognized as a gain on sale of fixed assets at Exhibit B.

See independent auditors report.

**Diamondhead Property Owners Association, Inc.**  
**NOTES TO FINANCIAL STATEMENTS**  
 (continued)  
 March 31, 2009

**NOTE 9: Income Taxes** - For the year ended March 31, 2009, the Association elected to be taxed on non-exempt function income, which resulted in no income tax. For regular corporate income-tax purposes, the Association has available a net operating loss of \$566,424 for federal income-tax purposes, which can be carried forward and used to reduce taxable income, subject to time and classification restrictions. For Arkansas income-tax purposes, the Association is a not-for-profit entity and is not subject to Arkansas income tax.

**NOTE 10: Reconciliation of Net Income to Net Cash Provided by Operating Activities** - At Exhibit D, the Association discloses cash flows from operating activities using the direct method. The following is a reconciliation of net income, as reflected at Exhibit B, to net cash provided by operating activities:

Net Income		\$ 674,324
Adjustment to Reconcile Net Income to Net		
Cash Provided by Operating Activities:		
Depreciation	\$ 79,246	
Bad debts	100,506	
Increase in accounts receivable	[200,389]	
Increase in inventory	[ 2,775]	
Increase in prepaid expenses	[ 10,651]	
Increase in utility deposits	[ 84]	
Increase in accounts payable	28,708	
Decrease in accrued expenses	[ 7,522]	
Decrease in deferred credits	[ 55,370]	
Interest income	[ 14,753]	
Gain on sale/transfer of assets	<u>[235,736]</u>	
Net Adjustment		<u>[318,820]</u>
Net Cash Provided by Operating Activities		<u>\$ 355,504</u>

See independent auditors report.

**Diamondhead Property Owners Association, Inc.**  
**SUPPLEMENTARY INFORMATION ON FUTURE, MAJOR**  
**REPAIRS AND REPLACEMENTS**  
**(Unaudited)**  
**March 31, 2009**

In August 1999, the Association's board of directors engaged an independent insurance agent to conduct a study to estimate the remaining, useful lives and the replacement costs of the common property components. The estimates were based on the estimated costs to repair or replace the common property components at the date of the study. Estimated, current replacement costs have not been revised since that date and do not take into account the effects of inflation between the date of the study and the date the components may require repair or replacement. The golf course had an estimated remaining useful life in excess of 30 years and was omitted from the study.

<u>Components</u>	<u>Estimated Remaining Useful Life</u>	<u>Estimated Replacement Cost</u>
Golf course sheds	25 years	\$ 91,000
Golf course restrooms	25 years	22,000
Main gate	25 years	9,000
Maintenance barn	25 years	156,000
Office and Nineteenth Hole building	25 years	267,000
Pavilions	25 years	7,000
Pool building	25 years	35,000
Pool and tennis court	20 years	203,000
Pro shop buildings	25 years	19,000
Security building	25 years	36,000
Storage buildings	25 years	<u>3,000</u>
		<u>\$ 848,000</u>

See independent auditors report.