

1. Organization

The Canterwood STEP System Association (STEP) is a non-profit corporation organized on June 16, 1994 under Chapter 24.03 of the Revised Codes of Washington for the purpose of providing sewage system and other services for the benefit of certain real property owners (members) within the Canterwood community in Pierce County, WA.

The STEP is managed by an elected Board of Directors (Board) pursuant to its Articles of Incorporation, Bylaws, and Covenants, Conditions & Restrictions (CC&Rs), as amended. The STEP utilizes a Financial Services Agent (currently Kalles Community Management) to, among other things, collect assessments from its members, pay bills on the STEP's behalf, keep its books and records, and prepare its financial statements and other reports. The STEP's annual federal tax returns are prepared by an independent certified public accountant and are current through calendar 2011. Other required tax filings are also all current.

2. Significant financial and accounting policies

The Board has formally adopted certain financial policies to ensure compliance with the Bylaws and CC&Rs. The STEP uses the modified accrual basis of accounting to record its financial activities. Current accounting practices include:

- A. Revenues from members and others for assessments, interest and fees are recognized when invoiced.
- B. Billings from the City of Gig Harbor, WA for sewage treatment services and from other vendors or consultants are recognized as expenses when paid.
- C. Bad debts are recognized as an expense when the collection of specific receivables from members is deemed unlikely regardless of any collection efforts underway. The Board intends to establish a formal policy for reserving for bad debts when time permits.
- D. Additions of capital assets of the system are recorded at cost and depreciated over their estimated useful lives, as follows: in-ground pipelines, valves and vaults-40 years; minor structures, meters, and other equipment -10 years.

3. Capital assets and replacement reserves

Virtually all existing system capital assets (in-ground pipelines, valves, vaults, etc., having a total estimated cost of \$820,000 for materials and installation) were donated to the STEP at no cost by the Canterwood developer at the time of incorporation or subsequently. No depreciation expense has been recorded on the donated assets which average 18 years of use at the end of 2011. The STEP built an effluent treatment facility that was put into operation in 2010 and has been recorded as a depreciable asset.

In December 2011, the Board established a new bank account from available accumulated member assessment funds in order to be able to finance future major system repairs (\$5000 or more), additions and replacements. The Board directed that these monies (initially \$80,000) be earmarked in the accounting records and financial statements as replacement reserves. These funds, while designated for that purpose, are not legally restricted and can be used for any STEP business purposes at the discretion of the Board. The Board intends to establish more specific replacement reserve policies in the future when time permits.

4. Other matters

The STEP is not involved in any litigation as either plaintiff or defendant. The STEP has filed liens against the property of five members for failure to pay their assessments and other fees over an extended period of time. The Board uses the assistance of legal counsel to file liens and to assist in other collection efforts.