

Canterwood STEP System Association
FINANCIAL POLICIES AND PROCEDURES

I. Introduction

This document outlines the financial policies and procedures of the Canterwood STEP System Association (STEP). The administration of, and compliance with, these policies is the responsibility of the elected Board of Directors (Board). These policies and procedures are subject to revision over time as circumstances dictate. Deviations from these policies and procedures, whether intentional or otherwise, should be documented sufficiently in the STEP's records to explain and justify such deviations whenever they occur. The specific policies and practices which follow may paraphrase certain provisions of the STEP's Bylaws and Covenants, Conditions & Restrictions (CC&Rs) and they are not intended to be all-inclusive.

II. Authority

These financial policies and procedures are authorized by the applicable sections of the STEP's Articles of Incorporation, Bylaws and CC&Rs, and, more generally, by the broad powers granted to Boards of Directors under RCW 24.03, et al.

III. General Financial Policies and Procedures

1. The Board and the representatives of the STEP's financial services agent will strive to comply fully with all fiscal practices and rules outlined in detail in the Bylaws and CC&Rs. Appropriate accounting procedures will be used to record all business activities and accurately prepare financial statements and reports.
2. The Board will establish member assessments, connection fees and other sources of income sufficient to ensure that all operating expenses and other financial obligations of the STEP are met as they become due and payable.
3. The Board will endeavor to control costs and expenditures in order to keep annual member assessments as low as possible while ensuring effective, legally compliant, and healthy and safe STEP operations on a continuous basis.
4. Member assessments will be derived based on annual operating and capital budgets as determined by the Board. The financial services agent will bill all members for regular assessments on a bi-monthly basis to help reduce administrative costs and to coincide with the bi-monthly invoices for sewage treatment from the City of Gig Harbor. The assessment amount charged to each member for each billing cycle will be uniform pursuant to Article V, Section 5.3, of the CC&Rs, although total billing amounts may vary from site to site (or member to member) due to one-time charges (such as connection fees) or other fees (such as late fees, interest or collection costs).
5. The Board will endeavor to ensure that a sufficient portion of member assessments are earmarked as reserve funds for emergencies, major repairs and additions to or replacements of system capital assets.
6. The Board will only impose special assessments on members in the event of a major emergency or fiscal urgency that is beyond the scope and purpose of normal operations or reserve practices.
7. As a general policy, the Board will not bind or subject the STEP to debt obligations (loans or long-term financial commitments) without a demonstrated need for such liabilities and without a clearly demonstrated ability of the STEP to be able to meet such obligations in the normal course of business as they become due and payable. The Board will ensure that any debt or long-term financial commitment that is considered material to the STEP's financial position is presented to and ratified by a majority vote of the STEP membership prior to incurring the obligation.

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8. The STEP's financial statements will be prepared on a monthly basis by the financial services agent in accordance with generally accepted accounting principles. At a minimum, the monthly financial statements will consist of a Balance Sheet, Statement of Income and Expenses, Statement of Income and Expense Variances to Budget, Bank Reconciliation, and Accounts Receivable Aging Report. These statements and reports will be prepared on a timely basis. Furthermore, they will contain sufficient details to permit the Board to make informed fiscal decisions at all times.
9. The STEP's calendar year-end federal tax return will be prepared by a licensed certified public accountant. The tax return should be completed and filed as soon after the end of each calendar year as is reasonably practicable. The Board will also engage an independent public accountant to conduct an audit of the STEP's annual financial statements and accounts if deemed warranted by the Board or so requested by a STEP member.
10. The Board will award contracts and hire vendors and consultants based on the lowest responsible bids or lowest competitive prices whenever possible. If deemed practicable, the Board will seek competitive bids for professional and other services rendered on the STEP's behalf. All decisions by the Board concerning contracts and large dollar expenditures will be documented in the STEP's financial records and Board meeting minutes.

IV. Significant accounting policies

The STEP uses the modified accrual basis of accounting to record its financial activities. Current accounting practices include:

1. Revenues from members for assessments, interest and fees are recognized when invoiced. Other revenues are generally recorded when received.
2. Billings from the City of Gig Harbor, WA for sewage treatment services and from other vendors or consultants are recognized as expenses when paid.
3. Prepaid expenses and deferred costs are recorded as assets and amortized as expenses in appropriate accounting periods as they expire.
4. Bad debts are recognized as expenses when the collection of specific receivables from members is deemed unlikely regardless of any collection efforts that are underway.
5. Additions or major renewals of system capital assets 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.

V. Cash Management Policies and Procedures

1. The Board will manage the STEP's cash and investment assets in a prudent and fiscally responsible manner at all times. A member of the Board will authorize and sign all payments made by checks. All other disbursements, cash transfers or investments made directly by the financial services agent must be authorized by the Board. All bank accounts will be reconciled monthly by the financial services agent and differences, if any, will be documented and explained to the Board.
2. The STEP must collect sufficient monies from members to cover its bills and other financial obligations at all times. Care will be taken by the Board and the financial services agent, using budgeting and cash management techniques, to ensure that sufficient funds are always available to effectively and efficiently manage the STEP's day to day operations. Amounts collected from members will be managed in a prudent manner and will be used solely for legitimate STEP business purposes.
3. The STEP's bank and investment accounts may contain large sums of monies pending disbursement for operating or capital needs. The Board will attempt to maximize the yields on all monies on hand so

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long as the funds are adequately protected and are readily available whenever needed utilizing the following guidelines:

Cash Management Objectives (in order of priority):

1. Safety and preservation of Principal
2. Sufficiency of Liquidity to ensure that funds are available when needed without penalty
3. Maximization of Yields

Acceptable Cash Management Vehicles:

1. Interest bearing checking accounts
2. U.S. Treasury Securities
3. Certificates of Deposits
4. Monet Market Funds/ Sweep vehicles

Investment Institutions Utilized:

1. Must be Federally Insured (FDIC) (SIPC)
2. Should offer convenient, cost-effective banking and investment services
3. May be based out-of-state so long as safety and yields are not compromised

Maturity Parameters:

Maximum maturity/demand feature/average life: 3 years maximum
If practicable, mix maturities (laddering) for flexibility while maximizing average yields

VI. Reserve Policies and Procedures

1. The Board will determine the amounts to be billed periodically to members during each year in the form of assessments to cover expected annual STEP operating costs, as well as major system maintenance costs (\$5000 or more), emergencies, and future additions to, and replacements of, system capital assets. These determinations shall be made annually prior to the start of a new calendar year as a result of developing both annual Operating and Capital Budgets. The financial services agent will bill, collect and account for assessments as directed by the Board using appropriate accounting practices in the circumstances.
2. In establishing and maintaining operating and reserve funding levels, the Board is committed to avoiding excessive charges to the membership. The Board will only seek those monies from members as it deems prudent and necessary to continuously carry out the STEP's business in a cost-effective manner.
3. Since the STEP currently bills member assessments bi-monthly, and since all billings and collections occur on a continuous basis over time, the Board is of the opinion that maintaining funds in the operating bank account equal to at least one sixth of the STEP's projected annual operating costs at all times is sufficient to ensure funding adequacy throughout the year.
4. In addition to maintaining adequate operating funds, the Board will strive to maintain sufficient amounts at all times in the STEP's reserve bank account to provide for future capital additions, replacements or major renewals, and unforeseen emergencies.
5. The Board may elect to have replacement reserve studies conducted periodically by qualified consultants. The results of such studies may serve as a basis for the establishment of minimal reserve account levels, although the Board has full discretion when setting reserve requirements, as well as in the use of such funds.

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6. Until such time as the Board, through operations analysis, formal reserve studies and other means, is able to: (1) identify specific capital assets (pipes, valves and facilities, etc.) that need to be added to the system in the years ahead, and (2) develop a comprehensive, detailed listing of such new system additions and other STEP system capital assets subject to future periodic replacement or renewal; the Board shall use best estimates to set minimum reserve requirements and annual funding needs.
7. Given the potential magnitude of eventual system capital asset replacement costs, the Board deems it prudent, for safety and emergency purposes, to establish a minimum reserve bank account balance at the start of any calendar year of \$80,000, together with any amounts being held by the STEP as builder deposits and all accumulated interest earnings on reserve bank account balances over time.
8. The proposed Capital Budget for the next year shall consist of funding needs for specifically identified capital asset additions, replacements or renewals; provisional estimates for unspecified capital assets in accordance with established **Budget Policies and Procedures**; or a combination of specific and provisional capital asset funding needs.
9. Monies collected from annual member assessments that are attributable to funding the Capital Budget requirements shall be transferred from the operating bank account to the reserve bank account periodically during the year by the financial services agent upon the direction of the Board.
10. Budgeted capital project monies that are unspent in any year shall remain in the reserve bank account for future years' capital needs unless the Board deems that there is a better or more urgent use for such funds elsewhere.
11. The Board shall monitor the status of the reserve bank account on a regular basis and will make adjustments to minimum balance requirements and other needs over time as the circumstances may dictate.

VII. Collection Policies and Procedures

1. The STEP will attempt to collect all monies due from members (or others) as soon as possible utilizing the standard billing and collection systems and procedures put in place by its financial services agent, acting on behalf of the STEP. The Board will be pro-active in pursuing the collection of delinquent member assessments. The financial services agent will issue a monthly report of delinquent accounts receivables to the Board.
2. The STEP Vice-President has been designated as the official in charge of periodically monitoring the status of member accounts in arrears and for dealing directly with the financial services agent and any collection attorneys hired by the STEP to handle such accounts.
3. The financial services agent will add a late fee of \$25 per month to each account receivable from STEP members that is in arrears beyond the stated due date of payment. Additional late fees of \$25 per month will continue to be added to any member receivable that remains in arrears over time until the delinquent account is brought to current status. Such posted late fees, together with delinquent balance amounts shown on subsequent STEP bi-monthly billings, shall serve as formal written notice to members in arrears and the STEP's demand for payment.
4. To simplify bookkeeping practices for the financial services agent and help reduce STEP administrative costs, no interest will be computed on and added to the delinquent member receivable balances as a matter of regular practice. Accrued interest and other collection fees or costs will be added to such accounts by the financial services agent when instructed to do so by the Board or by a collection attorney acting on the Board's behalf.
5. The Board shall discuss delinquent accounts receivables at its regular monthly meetings, with particular attention paid to old debts that are in collection and to more recent accounts in arrears that are increasing in amount from month to month.

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6. Once a delinquent member account reaches the magnitude of approximately \$500 (generally around six months after an initial bi-monthly billing cycle and a subsequent bi-monthly billing cycle have passed; and a third bi-monthly cycle is ready to be billed), the financial services agent will prepare and issue a “final notice” letter via certified mail to the member debtor warning that the account will be turned over for collection if not paid within 15 days of the date of such letter. If the debtor fails to respond and pay timely after the issuance of the final notice letter, the STEP Vice-President shall evaluate the account status with the financial services agent. If there is little or no evidence that the debtor intends to pay any time soon, the account shall be turned over to an attorney for collection.
7. On every account turned over to an attorney for collection, the Board will instruct the attorney to obtain a lien on the STEP member’s real property in Canterwood within 30 days if no agreed upon accommodation to pay is reached with the debtor member within that time. The collection attorney will also be instructed to proceed to seek a court judgment against the member debtor for all amounts due the STEP at that point, including the addition of compounded accrued interest at one (1) percent per month from the original date that the arrearage commenced, together with all other collection fees incurred by the STEP and any legal services costs as determined by the attorney.
8. If and when a court judgment is obtained against a member debtor, the Board will rely on the help and advice of the collection attorney to collect as soon as possible the amount awarded by the court to the maximum extent possible in the circumstances.
9. The Board has complete authority to settle all accounts receivables from debtors, either prior to the commencement of collection efforts or anytime thereafter. Generally, however, the Board’s shall seek to achieve full recovery of all amounts due to the STEP, including all added late fees, accrued interest, and legal and other fees.
10. While full recovery of member receivables is always the preferred result, the Board may decide to accept less than the full amounts owed prior to starting collection, during the collection process or as awarded in court judgments depending on the circumstances involved. Any settlements with debtors will be decided on a case by case basis in consultation with the collection attorney involved, if applicable. Such settlement actions with respect to any one debtor will not bind the Board to similar actions on other future debt negotiations with any other member debtors.
11. The Board shall disclose any decisions it makes to settle accounts receivables for less than full recovery in the minutes of regular Board meetings, including describing the factors leading to such decisions. This disclosure is deemed by the Board to represent adequate notification to the general membership of such actions if and when they occur.

VIII. Budget Policies and Procedures

1. Prior to the start of each calendar year, the Board will develop a proposed annual Operating Budget and a proposed Capital Budget for such year. Generally, these proposed budgets will be developed by the end of November, so that they can be mailed to the full STEP membership in advance of the general membership meeting in December of each year. The members in attendance at the annual membership meeting will be asked to ratify the proposed budgets at that meeting.
2. In establishing the estimated amounts for the next calendar year’s proposed Operating Budget, the Board, with input from the financial services agent, shall consider comparable actual costs of the current year, as reflected in the STEP’s monthly financial reports, as well as historical cost trends, and other known factors that may have a bearing on such cost estimates. The Board has wide latitude in making such budget estimates, but it will strive to make estimates that are accurate and reasonably conservative in order to avoid inflating funding needs.

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3. The Board shall make an annual estimate near the end of each calendar year of the costs of any specific capital asset additions, replacements or major renewals that are expected to be added, built or commenced in the next calendar year. This estimate shall be used to create an annual Capital Budget for the next calendar year.
4. In the event that data available to the Board at the time that the annual Capital Budget needs to be developed is not sufficient, with any degree of certainty, to prepare a meaningful and accurate Capital Budget for the next year, the Board shall make a provisional estimate ranging from \$5000 to \$15,000 of “unspecified” capital costs to be incurred during the next calendar year. These sums, which represent a cost range of about \$1.55 to \$4.65 per member per month, are deemed to be prudent for ensuring that the Board makes some minimal provision for additions to capital reserves each year for the long term sufficiency of the account consistent with established **Reserve Policies and Procedures**. In such instances, the Capital Budget for the next year shall be the provisional amount deemed appropriate by the Board.
5. Once the Board has developed both proposed Operating and Capital Budgets, it shall make a determination, using those budgets, of the projected member assessment requirements for the next calendar year. This information will be discussed with the members in attendance during the annual membership meeting in December.
6. The Board shall monitor the status of the adopted annual Operating and Capital Budgets on a regular basis throughout the year. Revisions may be made to those budgets during the year in the event that material changes in circumstances occur. While significant changes in the budgets can result in either increases or decreases in member assessment requirements over time, the Board will strive to minimize assessment changes during the course of any year if at all possible.

IX. Bad Debts Policies and Procedures

1. The STEP has established specific **Collection Policies and Procedures** in an effort to maximize the amounts it is able to collect from any member debtors whose accounts are arrears.
2. Because the STEP uses the modified accrual basis of accounting, it will not establish a formal reserve for bad debts. Bad debts shall be determined on an account by account basis.
3. A bad debt will be recognized and recorded as an expense (and receivable write-off) when the Board decides that the collection of a specific receivable from a member is deemed highly unlikely, in whole or in part, regardless of any collection or legal efforts that are underway.
4. Factors that will influence the Board’s decisions to declare a member account to be a bad debt include personal bankruptcy, court rulings, and a member’s demonstrated lack of financial resources or assets subject to lien or attachment by the STEP. In such cases, the Board shall be guided by the advice of the collection attorney who is working to recover the receivable for the STEP.
5. Member receivables that are determined to be bad debts and accordingly expensed, may, however, continue to be subject to ongoing collection or legal efforts if the collection attorney recommends that such continuing actions may prove beneficial at a future date.
6. The Board may elect to use an estimate of bad debt expense in developing the STEP’s annual Operating Budgets based on known collection factors, even if formal bad debts declarations have not yet been made with respect to certain accounts in arrears.
7. Whenever the Board makes a decision to declare a delinquent member receivable to be a bad debt and to charge it to expense, that decision shall be documented in the minutes of the Board meeting when such decision was made.
8. Any subsequent recoveries of declared bad debts that were previously charged to expense will be recorded as miscellaneous income in the accounting period that they are collected.

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X. Other Accounting Matters

From time to time, the Board has and will continue to establish other accounting or business practices that are specific to a particular subject or business area and are not deemed appropriate to be incorporated into these broad STEP financial policies and procedures. Examples of such adjunct policies include:

1. **Step System Requirements, Fees and Regulations** (as revised August 24, 2012)
2. **Accounting for Connection Fees (New STEP Hookups)** (dated August 24, 2012)

The STEP Board hereby adopts the aforementioned financial policies and procedures on this date of November 15, 2012.

President _____

Vice-President _____

Secretary _____

Co-Treasurer _____

Co-Treasurer _____