

STREAM HOUSE COMMUNITY ASSOCIATION
COMPARATIVE FINANCIAL STATEMENTS
DECEMBER 31, 2006 AND 2005

STREAM HOUSE COMMUNITY ASSOCIATION

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INDEPENDENT AUDITORS' REPORT

To the Owners
Stream House Community Association

We have audited the accompanying balance sheet of Stream House Community Association, a California mutual benefit corporation, as of December 31, 2006, and the related statements of revenues, expenses and changes in fund balances, 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. The prior year summarized comparative information is presented for comparative purposes only and has been extracted from the Stream House Community Association's financial statements presented by fund for 2005 on which we expressed an unqualified opinion in our report dated February 2, 2006.

We conducted our audit in accordance with auditing standards generally accepted in the United States. 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.

A current study of the Association's replacement funding program indicates that the Association is underfunded. Accordingly, it may be necessary to increase assessments, pass special assessments, or delay future repair/replacement obligations until sufficient funds are available.

In our opinion the accompanying financial statements referred to above present fairly, in all material respects, the financial position of Stream House Community Association as of December 31, 2006, 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.

The supplementary information on future major repairs and replacements that accompanies the basic financial statements 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.

Schonwit & Associates
SCHONWIT & ASSOCIATES

February 15, 2007

STREAM HOUSE COMMUNITY ASSOCIATION
BALANCE SHEET
AS OF DECEMBER 31, 2006
(WITH COMPARATIVE TOTALS FOR 2005)

	<u>2006</u>			<u>2005</u>
	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>Total</u>	<u>Total</u>
ASSETS				
Cash and cash equivalents [Note 6]	\$ 43,480	\$ 13,590	\$ 57,070	\$ 79,220
Member assessments receivable, less allowance for doubtful collection of \$2,300 at 12/31/06 and \$1,800 12/31/05	14,059	--	14,059	16,732
Capitalized loan fees, less accumulated amortization of \$1,625 at 12/31/06 and \$1,125 at 12/31/05	--	1,875	1,875	2,375
Prepaid insurance	1,342	--	1,342	1,248
Prepaid taxes	480	--	480	480
Total Assets	<u>\$ 59,361</u>	<u>\$ 15,465</u>	<u>\$ 74,826</u>	<u>\$ 100,055</u>
LIABILITIES				
Accounts payable	\$ 30,059	\$ --	\$ 30,059	\$ 57,296
Bank loan [Note 8]	--	232,560	232,560	290,078
Accrued interest payable	--	853	853	981
Prepaid assessments	4,250	--	4,250	1,920
Income taxes payable	10	--	10	10
Total Liabilities	34,319	233,413	267,732	350,285
FUND BALANCES	<u>25,042</u>	<u>(217,948)</u>	<u>(192,906)</u>	<u>(250,230)</u>
TOTAL LIABILITIES AND FUND BALANCES	<u>\$ 59,361</u>	<u>\$ 15,465</u>	<u>\$ 74,826</u>	<u>\$ 100,055</u>

See independent auditors' report and accompanying notes to financial statements.

STREAM HOUSE COMMUNITY ASSOCIATION
 STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND BALANCES
 FOR THE YEAR ENDED DECEMBER 31, 2006
 (WITH COMPARATIVE TOTALS FOR 2005)

	2006			2005
	Operating Fund	Replacement Fund	Total	Total
REVENUES				
Member assessments	\$ 385,440	\$ 112,560	\$ 498,000	\$ 458,160
Special assessments	--	--	--	21,514
Interest	174	129	303	248
Other income	5,910	--	5,910	5,885
Total Revenues	<u>391,524</u>	<u>112,689</u>	<u>504,213</u>	<u>485,807</u>
EXPENSES				
Utilities:				
Electricity	62,196	--	62,196	57,991
Water	20,255	--	20,255	53,878
Gas	1,918	--	1,918	2,500
Refuse	53,436	--	53,436	20,405
Telephone	--	--	--	564
Maintenance:				
Landscape maintenance and supplies	78,858	--	78,858	64,749
Stream and stream pumps	24,949	--	24,949	28,000
Patrol services	2,844	--	2,844	--
Lighting maintenance and supplies	6,424	--	6,424	12,869
Pool service, supplies and repairs	4,776	--	4,776	3,694
Janitorial service and supplies	1,704	--	1,704	1,503
Pest control	10,251	--	10,251	8,392
Plumbing repairs	4,955	--	4,955	--
Other common area maintenance	28,404	--	28,404	17,584
Replacement fund [Note 9]	--	60,037	60,037	64,751
Administrative:				
Insurance	34,322	--	34,322	35,249
Management fees	30,000	--	30,000	29,316
Professional fees	1,985	--	1,985	1,622
Income taxes [Note 3]	10	--	10	10
Postage and printing expense	1,135	--	1,135	1,080
Other administrative expenses	51	--	51	866
Amortization expense	--	500	500	500
Interest expense	--	17,379	17,379	20,772
Bad debt expense	500	--	500	1,800
Total Expenses	<u>368,973</u>	<u>77,916</u>	<u>446,889</u>	<u>428,095</u>
EXCESS OF REVENUES OVER EXPENSES	22,551	34,773	57,324	57,712
Beginning Fund Balances	88,224	(338,454)	(250,230)	(307,942)
Interfund Transfers	(85,733)	85,733	--	--
Ending Fund Balances	<u>\$ 25,042</u>	<u>\$ (217,948)</u>	<u>\$ (192,906)</u>	<u>\$ (250,230)</u>

See independent auditors' report and accompanying notes to financial statements.

STREAM HOUSE COMMUNITY ASSOCIATION
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2006
(WITH COMPARATIVE TOTALS FOR 2005)

	2005			2004
	Operating Fund	Replacement Fund	Total	Total
Excess of revenues over expenses:	\$ 22,551	\$ 34,773	\$ 57,324	\$ 57,712
Adjustments to reconcile excess of revenues over expenses to net cash provided/(used) by operating activities:				
Amortization	--	500	500	500
Decrease in member assessments receivable	2,673	--	2,673	1,981
(Increase)/decrease in prepaid insurance	(94)	--	(94)	67
Increase/(decrease) in accounts payable	(4,271)	(22,966)	(27,237)	42,030
Decrease in accrued interest payable	--	(128)	(128)	(171)
Decrease in bank overdraft	--	--	--	(7,385)
Increase/(decrease) in prepaid assessments	2,330	--	2,330	(953)
Decrease in other liability	--	--	--	(11,116)
Change in due to/(from) fund	48,154	(48,154)	--	--
Net cash provided/(used) by operating activities	71,343	(35,975)	35,368	82,665
Cash provided/(used) by financing activities:				
Principal loan payments	--	(57,518)	(57,518)	(50,554)
Interfund transfers	(85,733)	85,733	--	--
Net increase/(decrease) in cash	(14,390)	(7,760)	(22,150)	32,111
Cash at beginning of year	57,870	21,350	79,220	47,109
Cash at end of year	<u>\$ 43,480</u>	<u>\$ 13,590</u>	<u>\$ 57,070</u>	<u>\$ 79,220</u>

See independent auditors' report and accompanying notes to financial statements.

STREAM HOUSE COMMUNITY ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2006

NOTE 1. ORGANIZATION

Stream House Community Association [the Association] is a statutory homeowners association which was organized as a non-profit mutual benefit corporation in February 1982. The purpose of the Association is primarily to maintain, preserve and control the common areas of the Association. The Association consists of 166 residential units and is located in Orange, California.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Principles of Accounting - The books and records for the Association are maintained on the cash basis of accounting. For these financial statements, adjustments have been made at December 31, 2006 to convert the Association's records to the accrual basis of accounting. The tax returns are also reported on the accrual basis of accounting.

(b) Capitalization Policy and Depreciation - In accordance with industry standards, the Association has not capitalized in the financial statements the common area real property acquired at its inception from the developer. Replacements and improvements to the real property which are directly associated with the units are also not capitalized. They are instead charged directly to either operating or replacement funds in the period they are incurred.

Significant capital assets not directly associated with the units, referred to as personal property assets, are capitalized and depreciated over their estimated useful life using the straight-line method of depreciation. During the year ended December 31, 2006, there were no significant personal property additions.

(c) Fund Accounting - The Association's accompanying financial statements have been prepared using fund accounting. Under this method of accounting, funds are separated into two categories, the operating fund and the replacement fund. Disbursements from the replacement fund generally may be made only for designated repair or replacement of major common area components. Disbursements from the operating fund are at the discretion of the Board of Directors and generally are for on-going repairs, maintenance, and administrative functions.

(d) Investment Income - The Board's policy is to allocate interest earned on replacement fund cash accounts to the replacement fund, and to pay the related income taxes out of the operating fund.

(e) Use of 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 period. Actual results could differ from those estimates.

STREAM HOUSE COMMUNITY ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2006

NOTE 3. INCOME TAXES

The Association may elect to file its federal income tax return as either a regular corporation [under Internal Revenue Code Section 277] or as a homeowners association [under Internal Revenue Code Section 528]. For the year ended December 31, 2006, the Association elected to file as a homeowners association, where generally the association is taxed only on income unrelated to membership dues and assessments [such as interest income less related expenses]. For California purposes, the Association also qualifies for tax exempt status as a homeowners association and pays a tax of 8.84% on income not related to membership dues and assessments. For the year ended December 31, 2006, the federal and California income tax expense was \$0 and \$10, respectively.

NOTE 4. ASSESSMENTS AND ASSESSMENTS RECEIVABLE

Association members are subject to paying assessments to fund for the Association's operating expenses, future capital acquisitions, and major repairs and replacements. Assessments receivable at December 31, 2006 represent assessments and other fees due from owners. The Association's governing documents provide for various collection remedies for delinquent assessments, including filing of liens on the owner's unit, foreclosing on the unit owner, or obtaining judgment on other assets of the unit owner. At December 31, 2006, the Association has recorded an allowance for uncollectible assessments of \$2,300. This allowance represents an estimated amount which was calculated using historical collection information.

For the year ended December 31, 2006, the Association's monthly assessment was \$250 per unit. For 2007, the monthly assessment is budgeted to remain at \$250 per unit.

Additionally in 2005 the Association collected a special assessment of \$129.60 per unit for replacement fund purposes.

NOTE 5. REPLACEMENT FUNDING PROGRAM

In accordance with the Association's governing documents, which require that funds be accumulated for future major repairs and replacements, the Association has established certain amounts as reserves for future capital expenditures. Members' assessments relating to the replacement funding program are considered capital contributions from members' dues and as such are restricted in usage. Disbursements are to be made only if specifically approved by the Board of Directors.

An independent study of the Association's replacement funding program, which was conducted in November 2005, indicates that the Association is underfunded. Accordingly the study recommended contributions to the replacement fund of approximately \$208,130 for 2006 and \$213,854 for 2007. The study's recommendations were based on estimates of remaining useful lives, current replacement costs, and amounts accumulated in the replacement funds. For the year ended December 31, 2006, the Association funded \$112,560 from assessments to the replacement fund. The 2007 budget provides for this same amount. The table included in the unaudited supplementary information on future major repairs and replacements is based on the study.

Replacement funds are being accumulated based on estimates of future needs for repairs and replacements of common property components. Actual expenditures may vary from the estimated amounts and the variations may be material. Therefore, amounts accumulated in the replacement funds may not be adequate to meet all future needs for major repairs and replacements. If additional funds are needed, the Association has the right, subject to the Association's governing documents, to pass special assessments, increase monthly assessments, or delay replacement until funds are available.

STREAM HOUSE COMMUNITY ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2006

NOTE 6. SCHEDULE OF CASH BALANCES

Generally, certificates of deposit and other securities with original maturities less than 90 days are considered cash equivalents, while certificates of deposits and securities with maturities over 90 days are considered "investments."

At December 31, 2006 and 2005, the Association maintained cash balances at the following institutions:

<u>Operating Fund:</u>	<u>2006</u>	<u>2005</u>
Sunwest Bank - checking	<u>\$ 43,480</u>	<u>\$ 57,870</u>
 <u>Replacement Fund:</u>		
Sunwest Bank - money market	<u>\$ 13,590</u>	<u>\$ 21,350</u>

NOTE 7. SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

There were no cash payments for income taxes for the year ended December 31, 2006. Cash paid for interest on the bank loan totaled \$17,507 during the year. There were no non-cash investing or financing transactions during the year.

NOTE 8. BANK LOAN

In September 2003, the Association entered into a loan agreement with Sunwest Bank and obtained a loan in the amount of \$400,000. The loan, which matures September 10, 2010, requires monthly principal and interest payments of \$5,958.11. The loan balance at December 31, 2006 was \$232,560 and the effective interest rate was 6.5%. The loan is collateralized against the Association's right to levy and collect assessments.

NOTE 9. REPLACEMENT FUND EXPENDITURES

Replacement fund expenditures for the years ended December 31, 2006 and 2005 are as follows:

	<u>2006</u>	<u>2005</u>
Tree trimming	\$ 26,005	\$ 14,510
Roof repairs	2,790	11,680
Raingutter maintenance	9,971	9,620
Termite treatment	2,165	9,250
Stucco repairs	3,611	5,328
Patio furniture	6,318	--
Structural repairs	--	4,781
Plumbing	7,044	3,675
Water feature repairs	2,133	2,758
Fence repairs	--	2,543
Pool repairs	--	606
Total	<u>\$ 60,037</u>	<u>\$ 64,751</u>

STREAM HOUSE COMMUNITY ASSOCIATION
 SUPPLEMENTARY INFORMATION
 ON FUTURE MAJOR REPAIRS & REPLACEMENTS
 AS OF DECEMBER 31, 2006
 (UNAUDITED)

An independent reserve study was conducted in November 2005 to estimate the remaining useful lives and the replacement costs of the components of common property. The study was based upon representations by the Board of Directors and the experience and knowledge of the independent reserve analyst. The estimates were based on current replacement costs adjusted for an annual inflation rate of 3.0%. These estimates are used as a foundation in arriving at recommended funding requirements, based upon cash and investments which have been allocated for future repairs and replacements, earning a yield on investments of 3.0% (net of taxes).

The following table is based on the study and presents significant information about the components of common property.

<u>Common Area Component</u>	<u>Estimated Remaining Useful Lives</u>	<u>Estimated Current Replacement Costs</u>	<u>2006 Recommended Funding Requirement</u>	<u>Study's Recommended Fund Balance</u>
Painting	0-8 years	\$ 404,401	\$ 54,973	\$ 98,292
Lighting	1-5 years	113,775	6,901	93,284
Roofs	6-11 years	421,760	29,325	231,042
Pool/spa	0-1 years	20,025	2,467	18,327
Asphalt	3 years	79,511	6,911	61,362
Fences and railings	5-13 years	52,440	3,751	14,855
Irrigation controllers	0 years	12,800	1,051	12,800
Bridges	3 years	4,000	1,142	1,000
Termite	0 years	3,000	3,427	3,000
Decks	3-11 years	305,440	42,981	37,627
Mailboxes	8 years	12,955	987	6,046
Patio furniture	0 years	3,200	731	3,200
Doors and gates	8-13 years	72,150	5,866	10,270
Streams	0-9 years	53,100	42,048	46,610
Contingency	N/A years			
Total		<u>\$ 1,558,557</u>	<u>\$ 202,560</u>	<u>\$ 637,715</u>

Recommended funding requirement for 2007: \$ 213,854

Replacement fund balance at 12/31/06: * \$ (217,948)

* Negative balance due to presence of bank loan.