

STREAM HOUSE COMMUNITY ASSOCIATION
AUDITED FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012

STREAM HOUSE COMMUNITY ASSOCIATION

Table of Contents

Independent Auditors' Report	Pages 3-4
Balance Sheet with Comparative Totals	Page 5
Statement of Revenues, Expenses and Changes in Fund Balances with Comparative Totals	Page 6
Statement of Cash Flows with Comparative Totals	Page 7
Notes to Financial Statements	Pages 8-11
Supplementary Information on Future Major Repairs and Replacements	Page 12

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors and the Owners
Stream House Community Association

Report on the Financial Statements

We have audited the accompanying financial statements of Stream House Community Association, which comprise the balance sheets as of December 31, 2013, and the related statements of revenues, expenses, and changes in fund balances and cash flows for the years 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 audits. We conducted our audits 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 Stream House Community Association as of December 31, 2013, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Other Matter

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

Report on Summarized Comparative Information

We have previously audited the Stream House Community Association's 2012 financial statements, and we expressed an unmodified opinion on those financial statements in our report dated January 28, 2013. In our opinion, the summarized comparative information presented herein as of and for the year ended December 31, 2012, is consistent, in all material respects, with the audited financial statements from which it has been derived.

Disclaimer of Opinion on Required Supplementary Information

Accounting principles generally accepted in the United States of America require that supplementary information on future major repairs and replacements on page 12 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Financial Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Van Der Pol & Co.

VANDERPOL & COMPANY, A PAC

February 22, 2014

STREAM HOUSE COMMUNITY ASSOCIATION
BALANCE SHEET
AS OF DECEMBER 31, 2013
(WITH COMPARATIVE TOTALS FOR 2012)

	<u>2013</u>			<u>2012</u>
	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>Total</u>	<u>Total</u>
ASSETS				
Cash and cash equivalents [Note 7]	\$ 54,864	\$ 222,232	\$ 277,096	\$ 213,781
Member assessments receivable, less allowance for doubtful collection of \$500 at 12/31/13 and \$7,900 at 12/31/12	7,135	--	7,135	7,204
Prepaid insurance	103	--	103	103
Prepaid taxes	480	--	480	480
Due (to)/from fund	(1,542)	1,542	--	--
Total Assets	<u>\$ 61,040</u>	<u>\$ 223,774</u>	<u>\$ 284,814</u>	<u>\$ 221,568</u>
LIABILITIES				
Accounts payable	\$ 23,024	\$ --	\$ 23,024	\$ 26,963
Prepaid assessments	6,225	--	6,225	3,985
Income taxes payable	--	--	--	10
Total Liabilities	29,249	--	29,249	30,958
FUND BALANCES	<u>31,791</u>	<u>223,774</u>	<u>255,565</u>	<u>190,610</u>
TOTAL LIABILITIES AND FUND BALANCES	<u>\$ 61,040</u>	<u>\$ 223,774</u>	<u>\$ 284,814</u>	<u>\$ 221,568</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, 2013
(WITH COMPARATIVE TOTALS FOR 2012)

	<u>2013</u>			<u>2012</u>
	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>Total</u>	<u>Total</u>
REVENUES				
Member assessments	\$ 413,700	\$ 124,140	\$ 537,840	\$ 537,840
Interest	--	56	56	65
Bad debt recovery	3,699	--	3,699	4,433
Other income	8,438	--	8,438	6,155
Total Revenues	<u>425,837</u>	<u>124,196</u>	<u>550,033</u>	<u>548,493</u>
EXPENSES				
Utilities:				
Electricity	68,564	--	68,564	65,391
Water	55,616	--	55,616	62,190
Gas	2,142	--	2,142	2,005
Refuse	12,187	--	12,187	11,777
Maintenance:				
Landscape maintenance and supplies	80,063	--	80,063	88,323
Stream and stream pumps	25,420	--	25,420	25,532
Patrol services	3,317	--	3,317	3,254
Lighting maintenance and supplies	7,146	--	7,146	5,200
Pool service, supplies and repairs	9,819	--	9,819	4,061
Janitorial service and supplies	2,239	--	2,239	2,351
Pest control	9,998	--	9,998	12,448
Plumbing repairs	4,571	--	4,571	1,102
Other common area maintenance	61,059	--	61,059	65,009
Replacement fund [Note 9]	--	67,574	67,574	59,637
Administrative:				
Insurance	33,293	--	33,293	35,624
Management fees	34,800	--	34,800	31,900
Professional fees	4,643	--	4,643	3,183
Income taxes [Note 4]	--	--	--	10
Postage and printing expense	2,330	--	2,330	1,337
Other administrative expenses	297	--	297	95
Total Expenses	<u>417,504</u>	<u>67,574</u>	<u>485,078</u>	<u>480,429</u>
EXCESS OF REVENUES OVER EXPENSES	8,333	56,622	64,955	68,064
Beginning Fund Balances	<u>23,458</u>	<u>167,152</u>	<u>190,610</u>	<u>122,546</u>
Ending Fund Balances	<u>\$ 31,791</u>	<u>\$ 223,774</u>	<u>\$ 255,565</u>	<u>\$ 190,610</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, 2013
(WITH COMPARATIVE TOTALS FOR 2012)

	2013			2012
	Operating Fund	Replacement Fund	Total	Total
Excess of revenues over expenses:	\$ 8,333	\$ 56,622	\$ 64,955	\$ 68,064
Adjustments to reconcile excess of revenues over expenses to net cash provided by operating activities:				
Decrease in member assessments receivable	69	--	69	5,285
Decrease in prepaid insurance	--	--	--	2
Decrease in accounts payable	(3,939)	--	(3,939)	(1,599)
Increase in prepaid assessments	2,240	--	2,240	1,714
Decrease in income taxes payable	(10)	--	(10)	--
Net increase in cash	6,693	56,622	63,315	73,466
Cash at beginning of year	48,171	165,610	213,781	140,315
Cash at end of year	<u>\$ 54,864</u>	<u>\$ 222,232</u>	<u>\$ 277,096</u>	<u>\$ 213,781</u>

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

STREAM HOUSE COMMUNITY ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2013

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 a modified accrual basis of accounting. For these financial statements, adjustments have been made at December 31, 2013 to convert the Association's records to the full 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, 2013, 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 accounting principles generally accepted in the United States of America 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.

(f) Subsequent Events - Subsequent events have been evaluated through February 22, 2014, which is the date the financial statements were available to be issued.

NOTE 3. COMPARATIVE FINANCIAL STATEMENTS

The financial statements include certain prior year summarized comparative information in total, but not by fund. Such information does not include sufficient detail to constitute a presentation in conformity with accounting principles generally accepted in the United States of America. Accordingly, such information should be read in conjunction with the Association's financial statements for the year ended December 31, 2012, from which the summarized information was derived.

STREAM HOUSE COMMUNITY ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2013

NOTE 4. 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, 2013, 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, 2013, there was no federal or California income tax expense.

The Association utilizes the liability method of accounting for income taxes. Under the liability method deferred income tax assets and liabilities are provided based on the difference between the financial statements and tax basis of assets and liabilities measured by the currently enacted tax rates in effect for the years in which these differences are expected to reverse. Because there is no material difference between the financial accounting and tax basis of the Association's assets and liabilities, the Association has not recorded any deferred tax assets or liabilities.

The Association has adopted accounting standards for the accounting for uncertainty in income taxes. These standards provide guidance for the accounting and disclosure about uncertain tax positions taken by an association. Management believes that all of the positions taken by the Association in its federal and state income tax returns are more likely than not to be sustained upon examination. The Association's tax returns are subject to examination by the Internal Revenue Service and the California Franchise Tax Board, generally for three years and four years, respectively after they are filed.

NOTE 5. 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, 2013 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, 2013, the Association has recorded an allowance for uncollectible assessments of \$500. This allowance represents an estimated amount which was calculated using historical collection information.

For the year ended December 31, 2013, the Association's monthly assessment was \$270 per unit. For 2014, the monthly assessment has been raised to \$280 per unit. The Association has budgeted to collect a special assessment of \$168 per unit for replacement fund purposes.

NOTE 6. 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.

STREAM HOUSE COMMUNITY ASSOCIATION
 NOTES TO FINANCIAL STATEMENTS
 DECEMBER 31, 2013

NOTE 6. REPLACEMENT FUNDING PROGRAM – (CONTINUED)

An independent study of the Association's replacement funding program, which was conducted in October 2013, indicates that the Association is significantly underfunded. Accordingly, the study recommends a contribution to the replacement fund of approximately \$286,800 (\$143.98 per unit per month) for 2014. 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, 2013, the Association funded \$124,140 from assessments to the replacement fund. The 2014 budget includes a provision for replacement funding of \$186,948, which is inclusive of the special assessment discussed in Note 5. 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.

NOTE 7. SCHEDULE OF CASH BALANCES

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

At December 31, 2013 and 2012, the Association maintained cash balances at the following institution:

<u>Operating Fund:</u>	<u>2013</u>	<u>2012</u>
Wells Fargo Bank - checking	<u>\$ 54,864</u>	<u>\$ 48,171</u>
<u>Replacement Fund:</u>		
Wells Fargo Bank - savings	<u>\$ 222,232</u>	<u>\$ 165,610</u>

NOTE 8. SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

Cash paid for income taxes amounted to \$10 for the year ended December 31, 2013. There were no non-cash investing or financing transactions during the year.

STREAM HOUSE COMMUNITY ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2013

NOTE 9. REPLACEMENT FUND EXPENDITURES

Replacement fund expenditures for the years ended December 31, 2013 and 2012 are as follows:

	<u>2013</u>	<u>2012</u>
Rain gutter and roof maintenance	\$ 60,032	\$ 33,741
Pool/spa repairs	4,051	--
Concrete work	3,491	2,871
Deck repairs	--	7,899
Stream repairs	--	4,500
Landscape	--	2,747
Pool furniture	--	2,474
Lighting/electrical repairs	--	1,407
Other common area repairs	--	1,312
Dry rot/termite repairs	--	952
Plumbing repairs	--	897
Irrigation	--	837
	<u> </u>	<u> </u>
Total	<u>\$ 67,574</u>	<u>\$ 59,637</u>

STREAM HOUSE COMMUNITY ASSOCIATION
 REQUIRED SUPPLEMENTARY INFORMATION
 ON FUTURE MAJOR REPAIRS & REPLACEMENTS
 AS OF DECEMBER 31, 2013
 (UNAUDITED)

An independent reserve study was conducted in October 2013 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 3.5%. 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 1.0% (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>2014 Recommended Funding Requirement</u>	<u>Study's Recommended Fund Balance</u>
Decks	1-7 years	\$ 357,000	51,674	\$ 210,188
Asphalt	2-11 years	360,000	35,876	226,000
Lighting	4-5 years	148,250	9,734	119,327
Mailboxes	0 years	1,750	2,854	1,750
Pool/spa	0-14 years	33,850	4,914	12,724
Fences/railings	7-9 years	68,800	5,405	40,223
Utility doors	0 years	2,500	4,078	2,500
Trash access gates	5 years	13,100	1,424	8,732
Pool furniture	3 years	2,500	815	1,000
Bathroom	5 years	5,500	449	4,125
Irrigation	0-1 year	18,150	7,198	17,803
Painting	0-5 years	444,550	86,517	303,205
Roofs	0-7 years	572,800	55,673	473,030
Bridge	19 years	10,750	702	2,580
Streams	0-2 years	19,950	19,487	15,950
Total		<u>\$ 2,059,450</u>	<u>\$ 286,800</u>	<u>\$ 1,439,137</u>
Replacement Fund balance at 12/31/13:				<u>\$ 223,774</u>