

VanDerPol and Company

A Professional Accountancy Corporation

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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 sheet as of December 31, 2019, and the related statements of revenues, expenses, and changes in fund balances and cash flows for the year 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 audit. We conducted our audit 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, 2019, 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 of America.

Other Matter

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 assessment(s), or delay repair or replacement obligations until sufficient funds are available.

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 13 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.

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A Professional Accountancy Corporation

Costa Mesa, California

May 15, 2020

STREAM HOUSE COMMUNITY ASSOCIATION
BALANCE SHEET
AS OF DECEMBER 31, 2019

	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>Total</u>
ASSETS			
Cash and cash equivalents [Note 8]	\$ 43,344	\$ 349,898	\$ 393,242
Member assessments receivable	6,369	--	6,369
Accrued interest receivable	--	7	7
Other receivable	925	--	925
Prepaid insurance	1,020	--	1,020
Prepaid taxes	--	466	466
Due (to)/from fund	<u>(68,588)</u>	<u>68,588</u>	<u>--</u>
Total Assets	<u>\$ (16,930)</u>	<u>\$ 418,959</u>	<u>\$ 402,029</u>
LIABILITIES			
Accounts payable	\$ 33,141	\$ --	\$ 33,141
Prepaid assessments	9,349	--	9,349
Contract liability [Note 4]	<u>--</u>	<u>418,478</u>	<u>418,478</u>
Total Liabilities	42,490	418,478	460,968
FUND BALANCES	<u>(59,420)</u>	<u>481</u>	<u>(58,939)</u>
TOTAL LIABILITIES AND FUND BALANCES	<u>\$ (16,930)</u>	<u>\$ 418,959</u>	<u>\$ 402,029</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, 2019

	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>Total</u>
REVENUES			
Member assessments [Note 3]	\$ 500,283	\$ 426,175	\$ 926,458
Interest	--	495	495
Bad debt recovery	306	--	306
Other income	9,859	--	9,859
	<u>510,448</u>	<u>426,670</u>	<u>937,118</u>
Total Revenues			
EXPENSES			
Utilities:			
Electricity	51,300	--	51,300
Water	98,809	--	98,809
Gas	2,560	--	2,560
Refuse	13,215	--	13,215
Telephone	--	--	--
Maintenance:			
Landscape maintenance and supplies	68,281	--	68,281
Irrigation repairs	16,125	--	16,125
Tree maintenance	5,325	--	5,325
Patrol service	3,895	--	3,895
Pool service, supplies and repairs	9,759	--	9,759
Stream and stream pumps	38,023	--	38,023
Lighting maintenance and supplies	16,751	--	16,751
Janitorial service and supplies	4,014	--	4,014
Pest and termite control	12,919	--	12,919
Roof repairs	7,355	106,588	113,943
Water damage and related repairs	124,808	28,945	153,753
Other common area maintenance	20,615	6,196	26,811
Wood repairs and painting	--	284,446	284,446
Administrative:			
Insurance	61,107	--	61,107
Management fees	27,990	--	27,990
Professional fees	9,182	--	9,182
Income taxes [Note 7]	--	14	14
Postage and printing expense	10,493	--	10,493
Other administrative expenses	2,990	--	2,990
	<u>605,516</u>	<u>426,189</u>	<u>1,031,705</u>
Total Expenses			
EXCESS OF REVENUES OVER/(UNDER) EXPENSES	(95,068)	481	(94,587)
Beginning Fund Balances [Note 5]	<u>35,648</u>	<u>--</u>	<u>35,648</u>
Ending Fund Balances	<u>\$ (59,420)</u>	<u>\$ 481</u>	<u>\$ (58,939)</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, 2019

	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>Total</u>
Cash flows from operating activities			
Excess of revenues over/(under) expenses	\$ (95,068)	\$ 481	\$ (94,587)
Adjustments to reconcile excess of revenues over/(under) expenses to net cash provided/(used) by operating activities:			
Decrease in member assessments receivable	16,120	--	16,120
Increase in accrued interest receivable	--	(7)	(7)
Increase in other receivable	(925)	--	(925)
Increase in prepaid insurance	(917)	--	(917)
(Increase)/decrease in prepaid taxes	480	(466)	14
Increase in accounts payable	28,894	--	28,894
Decrease in prepaid assessments	(1,052)	--	(1,052)
Decrease in income taxes payable	(10)	--	(10)
Decrease in contract liability	--	(319,894)	(319,894)
Change in due to/(from) fund	<u>27,875</u>	<u>(27,875)</u>	<u>--</u>
Net decrease in cash	(24,603)	(347,761)	(372,364)
Cash at beginning of year	<u>67,947</u>	<u>697,659</u>	<u>765,606</u>
Cash at end of year	<u>\$ 43,344</u>	<u>\$ 349,898</u>	<u>\$ 393,242</u>

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

STREAM HOUSE COMMUNITY ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2019

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

Principles of Accounting - The books and records for the Association are maintained on the accrual basis of accounting. The tax returns are also reported on the accrual basis of accounting.

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 the Operating Fund or the Replacement Fund 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, 2019, there were no significant personal property additions.

Fund Accounting - The Association's accompanying financial statements have been prepared using fund accounting. Under this method of accounting, financial resources 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.

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 Replacement Fund.

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.

NOTE 3. ASSESSMENTS AND ASSESSMENTS RECEIVABLE

Association members are subject to paying assessments to fund the Association's operating expenses, future capital acquisitions, and major repairs and replacements. Assessment revenue is recognized as the related performance obligations are satisfied at transaction amounts expected to be collected.

STREAM HOUSE COMMUNITY ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2019

NOTE 3. ASSESSMENTS AND ASSESSMENTS RECEIVABLE – (CONTINUED)

Under the new revenue recognition standard of ASC 606 [Note 5], the Association (an entity) has a performance obligation to the unit/unit owners (customers). The Association's approved annual Operating Fund budget establishes the maintenance, management, and administrative services it is obligated to perform. These services can be bundled together as a single commercial objective and a single performance obligation. The budget establishes an implied contract price, and because these services are provided within an annual cycle, the respective Operating Fund assessments are considered revenue for the current period.

The performance obligations related to Replacement Fund assessments are satisfied when these financial resources are expended for their designated purpose.

For the year ended December 31, 2019, the Association's monthly assessment was \$304.50 per unit. For 2020, the monthly assessment has been raised to \$335 per unit.

Assessments receivable at December 31, 2019 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.

Under ASC 606, assessments and other fees that cannot be collected with certainty are now charged against the respective revenue rather than bad debt expense. Bad debt expense will still be used to account for uncollectible receivable balances that were recorded in prior periods.

NOTE 4. CONTRACT LIABILITY

The Association recognizes revenue from members as the related performance obligations are satisfied. A contract liability is recorded when the Association has the right to receive payment in advance of the satisfaction of performance obligations which specifically pertains to Replacement Fund assessments. The contract liability balance at the beginning of the year and end of the year was \$0 and \$418,478, respectively.

NOTE 5. REVENUE RECOGNITION

The Financial Accounting Standards Board (FASB) issued new guidance in the Accounting Standards Codification (ASC) Topic 606 Revenue from Contracts with Customers. FASB ASC 606 is a new revenue recognition standard that affects businesses that enter into contracts with customers to transfer goods and services, including public, private and non-public entities. The purpose of the standard is to eliminate variations in the way businesses across industries handle accounting for similar transactions. FASB ASC 606 went into effect for annual reporting periods beginning after December 15, 2018. FASB ASC 606 supersedes the revenue recognition requirements of FASB ASC 972-605 and most industry-specific revenue guidance in the FASB ASC, including the accounting guidance that Common Interest Realty Associations (CIRAs) followed in previous years.

STREAM HOUSE COMMUNITY ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2019

NOTE 5. REVENUE RECOGNITION – (CONTINUED)

The Association has adopted the new guidance as of January 1, 2019, using the modified retrospective method of transition, which requires that the cumulative effect of the changes related to the adoption be charged to the beginning fund balance. Adoption of the new guidance resulted in changes to our accounting policies for assessments and contract liability [discussed in Notes 3 and 4].

The adoption of the new revenue recognition guidance resulted in the following change to beginning fund balances as of January 1, 2019:

	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>Total</u>
Fund balances, as previously reported, at January 1, 2019	\$ 35,648	\$ 738,372	\$ 774,020
Adjustment	--	(738,372)	(738,372)
Fund balances, as adjusted, at January 1, 2019	<u>\$ 35,648</u>	<u>\$ --</u>	<u>\$ 35,648</u>

The modified retrospective method of transition requires disclosure of the effect of applying the new guidance on each item included in these financial statements. The following items that were affected on the balance sheet, the statement of revenues, expenses, and changes in fund balances and the statement of cash flows for the year ended December 31, 2019 are as follows:

	<u>Amounts That Would Have Been Reported</u>	<u>Effects of Applying New Guidance</u>	<u>As Reported</u>
BALANCE SHEET			
Liabilities			
Contract liability [Note 4]	\$ --	\$ 418,478	\$ 418,478
Total Liabilities	42,490	418,478	460,968
Fund Balances	359,539	(418,478)	(58,939)

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND BALANCES

Revenues

Member assessments	\$ 606,564	\$ 319,894	\$ 926,458
Excess of revenues over/(under) expenses	(414,481)	319,894	(94,587)

STATEMENT OF CASH FLOWS

Excess of revenues over/(under) expenses	\$ (414,481)	\$ 319,894	\$ (94,587)
Decrease in contract liability	--	(319,894)	(319,894)

STREAM HOUSE COMMUNITY ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2019

NOTE 5. REVENUE RECOGNITION – (CONTINUED)

The effect of the adoption is an increase in 2019 assessments of \$319,894 and a recorded contract liability at December 31, 2019 of \$418,478. The Association has no customer contract modifications that had an effect on the Association's transition to the new guidance.

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.

An independent study of the Association's replacement funding program, which was conducted in August 2019, indicates that the Association is underfunded. Accordingly, the study recommends a contribution to the Replacement Fund of approximately \$195,600, along with a special assessment of \$830,000 for 2020. The study's recommendations were based on estimates of remaining useful lives, current replacement costs, and amounts accumulated in the Replacement Fund. For the year ended December 31, 2019, the Association funded \$106,281 from assessments to the Replacement Fund. The 2020 budget includes a provision for replacement funding of \$131,271 (\$65.90 per unit per month). The table included in the unaudited supplementary information on future major repairs and replacements is based on the study.

The Association is funding such major repairs and replacements over the estimated useful lives of the components based on the study's estimates of current replacement costs, considering amounts previously accumulated in the Replacement Fund. Actual expenditures may vary from the estimated amounts and the variations may be material. Therefore, amounts collected for replacement obligations 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. 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, 2019, 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 under California Revenue and Taxation Code Section 23701t and pays a tax of 8.84% on income not related to membership dues and assessments. For the year ended December 31, 2019, the federal and California income tax expense was \$14 and \$0, respectively.

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.

STREAM HOUSE COMMUNITY ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2019

NOTE 7. INCOME TAXES – (CONTINUED)

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 8. 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, 2019, the Association maintained cash balances at the following institutions:

Operating Fund:

Pacific Western Bank - checking	\$ 43,344
	<u> </u>

Replacement Fund:

Pacific Western Bank - money market	\$ 231,998
Wells Fargo Bank - savings	117,900
	<u> </u>
Total Cash - Replacement Fund	<u>\$ 349,898</u>

NOTE 9. SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

There were no cash payments for income taxes for the year ended December 31, 2019. No interest was paid and there were no non-cash investing or financing transactions during the year.

NOTE 10. CONCENTRATION OF RISK

At December 31, 2019, the Association maintained funds at one financial institution whereby the cumulative balances on account exceeded FDIC insurance limits of \$250,000. At December 31, 2019, \$25,342 was exposed to this risk.

NOTE 11. SUBSEQUENT EVENTS

Subsequent events have been evaluated through May 15, 2020, which is the date the financial statements were available to be issued.

STREAM HOUSE COMMUNITY ASSOCIATION
 REQUIRED SUPPLEMENTARY INFORMATION
 ON FUTURE MAJOR REPAIRS & REPLACEMENTS
 AS OF DECEMBER 31, 2019
 (UNAUDITED)

An independent reserve study was conducted in August 2019 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 collected for future repairs and replacements, earning a yield on funds of 1.0% (net of taxes).

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

Common Area Component	Estimated Remaining Useful Lives	Estimated Current Replacement Costs	2020 Recommended Funding Requirement	Study's Recommended Fund Balance
Asphalt/concrete	0-4 years	\$ 222,500	\$ 23,742	\$ 190,833
Roofs	0-3 years	1,058,500	62,388	969,950
Decks	0-1 year	335,000	30,981	317,813
Utility doors	4 years	18,700	3,600	3,740
Wood work	4 years	40,000	7,700	8,000
Lighting	4-10 years	124,400	4,920	93,656
Fences/railings	3-4 years	82,500	4,837	63,192
Painting	3-9 years	193,300	22,451	23,325
Pool area	0-8 years	92,300	6,106	74,263
Streams	0-23 years	265,000	24,237	167,921
Irrigation	3-6 years	28,900	1,719	20,110
Mailboxes	0 years	2,100	2,021	2,100
Trash access gates	3 years	14,000	898	11,200
	Total	<u>\$ 2,477,200</u>	<u>\$ 195,600</u>	<u>\$ 1,946,103</u>
The accumulated contract liability and Replacement Fund balance at 12/31/19:				<u>\$ 418,959</u>