

STREAM HOUSE COMMUNITY ASSOCIATION
COMPARATIVE FINANCIAL STATEMENTS
DECEMBER 31, 2012 AND 2011

STREAM HOUSE COMMUNITY ASSOCIATION

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INDEPENDENT AUDITORS' REPORT

To 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, 2012, 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. 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 2011 on which we expressed an unqualified opinion in our report dated February 20, 2012.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of the 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 the 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. 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 involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of 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

A recent 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 or replacement obligations until sufficient funds are available.

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, 2012, 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.

Report on 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 American Institute of Certified Public Accountants, who considers it to be an essential part of financial reporting and for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. Such information was not audited or reviewed by us and, accordingly, we do not express an opinion or provide any assurance on it.

Schonwit & Co.
SCHONWIT & COMPANY

January 28, 2013

STREAM HOUSE COMMUNITY ASSOCIATION
BALANCE SHEET
AS OF DECEMBER 31, 2012
(WITH COMPARATIVE TOTALS FOR 2011)

	2012			2011
	Operating Fund	Replacement Fund	Total	Total
ASSETS				
Cash and cash equivalents [Note 7]	\$ 48,171	\$ 165,610	\$ 213,781	\$ 140,315
Member assessments receivable, less allowance for doubtful collection of \$7,900 at 12/31/12 and \$10,900 at 12/31/11	7,204	--	7,204	12,489
Prepaid insurance	103	--	103	105
Prepaid taxes	480	--	480	480
Due (to)/from fund	(1,542)	1,542	--	--
Total Assets	\$ 54,416	\$ 167,152	\$ 221,568	\$ 153,389
LIABILITIES				
Accounts payable	\$ 26,963	\$ --	\$ 26,963	\$ 28,562
Prepaid assessments	3,985	--	3,985	2,271
Income taxes payable	10	--	10	10
Total Liabilities	30,958	--	30,958	30,843
FUND BALANCES	23,458	167,152	190,610	122,546
TOTAL LIABILITIES AND FUND BALANCES	\$ 54,416	\$ 167,152	\$ 221,568	\$ 153,389

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, 2012
(WITH COMPARATIVE TOTALS FOR 2011)

	<u>2012</u>			<u>2011</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
Special assessment [Note 5]	--	--	--	26,892
Interest	--	65	65	45
Other income	6,155	--	6,155	5,045
Total Revenues	<u>419,855</u>	<u>124,205</u>	<u>544,060</u>	<u>569,822</u>
EXPENSES				
Utilities:				
Electricity	65,391	--	65,391	65,449
Water	62,190	--	62,190	49,873
Gas	2,005	--	2,005	2,453
Refuse	11,777	--	11,777	11,535
Maintenance:				
Landscape maintenance and supplies	88,323	--	88,323	99,104
Stream and stream pumps	25,532	--	25,532	25,157
Patrol services	3,254	--	3,254	3,700
Lighting maintenance and supplies	5,200	--	5,200	5,604
Pool service, supplies and repairs	4,061	--	4,061	4,969
Janitorial service and supplies	2,351	--	2,351	2,281
Pest control	12,448	--	12,448	13,268
Plumbing repairs	1,102	--	1,102	6,609
Other common area maintenance	65,009	--	65,009	36,519
Replacement fund [Note 9]	--	59,637	59,637	167,878
Administrative:				
Insurance	35,624	--	35,624	34,292
Management fees	31,900	--	31,900	34,800
Professional fees	3,183	--	3,183	2,584
Income taxes [Note 4]	10	--	10	10
Postage and printing expense	1,337	--	1,337	2,029
Other administrative expenses	95	--	95	980
Bad debt expense/(recovery)	(4,433)	--	(4,433)	1,468
Total Expenses	<u>416,359</u>	<u>59,637</u>	<u>475,996</u>	<u>570,562</u>
EXCESS OF REVENUES OVER/(UNDER) EXPENSES	3,496	64,568	68,064	(740)
Beginning Fund Balances	<u>19,962</u>	<u>102,584</u>	<u>122,546</u>	<u>123,286</u>
Ending Fund Balances	<u>\$ 23,458</u>	<u>\$ 167,152</u>	<u>\$ 190,610</u>	<u>\$ 122,546</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, 2012
(WITH COMPARATIVE TOTALS FOR 2011)

	2012			2011
	Operating Fund	Replacement Fund	Total	Total
Excess of revenues over/(under) expenses:	\$ 3,496	\$ 64,568	\$ 68,064	\$ (740)
Adjustments to reconcile excess of revenues over/(under) expenses to net cash provided/(used) by operating activities:				
(Increase)/decrease in member assessments receivable	5,285	-	5,285	(1,781)
Decrease in prepaid insurance	2	-	2	102
Increase/(decrease) in accounts payable	(1,599)	-	(1,599)	3,042
Increase/(decrease) in prepaid assessments	1,714	-	1,714	(1,546)
Net increase/(decrease) in cash	8,898	64,568	73,466	(923)
Cash at beginning of year	39,273	101,042	140,315	141,238
Cash at end of year	<u>\$ 48,171</u>	<u>\$ 165,610</u>	<u>\$ 213,781</u>	<u>\$ 140,315</u>

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

STREAM HOUSE COMMUNITY ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012

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, 2012 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, 2012, 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.

(f) Subsequent Events - Subsequent events have been evaluated through January 28, 2013, 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 generally accepted accounting principles. Accordingly, such information should be read in conjunction with the Association's financial statements for the year ended December 31, 2011, from which the summarized information was derived.

STREAM HOUSE COMMUNITY ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012

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, 2012, 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, 2012, the federal and California income tax expense was \$0 and \$10, 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.

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, 2012 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, 2012, the Association has recorded an allowance for uncollectible assessments of \$7,900. This allowance represents an estimated amount which was calculated using historical collection information.

For the year ended December 31, 2012, the Association's monthly assessment was \$270 per unit. For 2013, the monthly assessment is budgeted to remain at \$270 per unit.

In 2011, the Association collected a one-time special assessment of \$162 per unit for asphalt work.

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, 2012

NOTE 6. REPLACEMENT FUNDING PROGRAM – (CONTINUED)

An independent study of the Association's replacement funding program, which was conducted in 2012, indicated that the Association is underfunded. Accordingly, the study recommended a contribution to the replacement fund of approximately \$258,960, along with a \$425,000 special assessment. 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, 2012, the Association funded \$124,140 from assessments to the replacement fund and has budgeted to fund the same amount for 2013. 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, 2012 and 2011, the Association maintained cash balances at the following institutions:

<u>Operating Fund:</u>	<u>2012</u>	<u>2011</u>
Wells Fargo Bank - checking	<u>\$ 48,171</u>	<u>\$ 39,273</u>
<u>Replacement Fund:</u>		
Wells Fargo Bank - savings	<u>\$ 165,610</u>	<u>\$ 101,042</u>

NOTE 8. SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

There were no cash payments for income taxes for the year ended December 31, 2012. There were no non-cash investing or financing transactions during the year.

STREAM HOUSE COMMUNITY ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012

NOTE 9. REPLACEMENT FUND EXPENDITURES

Replacement fund expenditures for the years ended December 31, 2012 and 2011 are as follows:

	<u>2012</u>	<u>2011</u>
Rain gutter and roof maintenance	\$ 33,741	\$ 23,575
Deck repairs	7,899	35,090
Stream repairs	4,500	--
Concrete work	2,871	23,332
Landscape	2,747	1,750
Pool furniture	2,474	--
Lighting/electrical repairs	1,407	9,674
Other common area repairs	1,312	--
Dry rot/termite repairs	952	9,159
Plumbing repairs	897	3,069
Irrigation	837	--
Asphalt work	--	49,889
Painting	--	5,753
Window repairs/replacements	--	2,480
Mailboxes	--	1,712
Drywall repairs	--	917
Storage closets	--	908
Stucco repairs	--	570
	<u> </u>	<u> </u>
Total	<u>\$ 59,637</u>	<u>\$ 167,878</u>

STREAM HOUSE COMMUNITY ASSOCIATION
 REQUIRED SUPPLEMENTARY INFORMATION
 ON FUTURE MAJOR REPAIRS & REPLACEMENTS
 AS OF DECEMBER 31, 2012
 (UNAUDITED)

The reserve study was updated in 2012 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 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>Study's Recommended Fund Balance</u>
Painting	0-3 years	\$ 506,200	\$ 436,750
Lighting	0 years	20,700	20,700
Roofs	0-4 years	611,300	595,960
Pool/spa	0-7 years	24,700	18,260
Asphalt	3-4 years	223,600	181,720
Tree maintenance	0 years	31,100	31,100
Irrigation controllers	0-3 years	20,100	19,600
Patio furnitures	0 years	4,500	4,500
Termite	0 years	3,800	3,800
Streams	0-7 years	123,200	94,320
Mailboxes	0 years	16,200	16,200
Decks	0-5 years	377,400	289,310
Fences/railings	0-7 years	64,300	61,840
Doors	6 years	78,000	57,420
Gates	1 year	12,200	11,340
Bridge	21 years	10,000	3,310
Total		<u>\$ 2,127,300</u>	<u>\$ 1,846,130</u>
Replacement Fund balance at 12/31/12:			<u>\$ 167,152</u>
Study's recommended funding requirement:			<u>\$ 258,960</u>