

NEWPORT HILLS COMMUNITY ASSOCIATION

Audited Financial Statements

For The Year Ended December 31, 2016

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INDEPENDENT AUDITORS' REPORT

Board of Directors
Newport Hills Community Association

We have audited the accompanying financial statements of Newport Hills Community Association, which comprise the balance sheet as of December 31, 2016, and the related statements of revenue and expenses and association funds, 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 Newport Hills Community Association as of December 31, 2016, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.



Robert A. Owens, CPA A PAC

February 10, 2017

NEWPORT HILLS COMMUNITY ASSOCIATION
BALANCE SHEET
DECEMBER 31, 2016

	OPERATING FUND	REPLACEMENT FUND	TOTAL
ASSETS			
Cash	\$ 325,629	\$ 866,747	\$ 1,192,376
Short-Term Investments	-	285,312	285,312
Assessments Receivable	6,878	-	6,878
Less: Allowance For Doubtful Accounts	(4,367)	-	(4,367)
Prepaid Taxes	233	-	233
Prepaid Insurance	6,872	-	6,872
Prepaid Expenses	7,000	-	7,000
Total Assets	\$ 342,245	\$ 1,152,059	\$ 1,494,304
LIABILITIES AND ASSOCIATION FUNDS			
Liabilities			
Accounts Payable	\$ 14,241	\$ -	\$ 14,241
Prepaid Assessments	4,662	-	4,662
Architectural Deposits	204,822	-	204,822
Payroll Liabilities	326	-	326
Income Taxes Payable	10	-	10
Total Liabilities	224,061	-	224,061
Commitments	-	-	-
Association Funds	118,184	1,152,059	1,270,243
Total Liabilities And Association Funds	\$ 342,245	\$ 1,152,059	\$ 1,494,304

SEE INDEPENDENT AUDITORS' REPORT AND ACCOMPANYING NOTES

NEWPORT HILLS COMMUNITY ASSOCIATION
STATEMENT OF REVENUE EXPENSES AND ASSOCIATION FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2016

	OPERATING FUND	REPLACEMENT FUND	TOTAL
REVENUE			
Assessments	\$ 491,290	\$ 141,790	\$ 633,080
Clubhouse/Recreation Center Rental Income	20,880	-	20,880
Interest Income	-	657	657
Swim Program	7,452	-	7,452
Bad Debt Recovery	4,132	-	4,132
Swim Team Collection	93,257	-	93,257
Other Income	14,235	-	14,235
Total Revenue	631,246	142,447	773,693
EXPENSES			
Landscape Maintenance	89,331	-	89,331
Management Fees	68,000	-	68,000
Administrative	20,833	-	20,833
Legal And Audit	10,139	-	10,139
Insurance	30,094	-	30,094
Pool	27,954	2,780	30,734
Rubbish Collection	4,424	-	4,424
Pest Control	330	-	330
Cable/Telephone/Internet	5,757	-	5,757
Spring Cleanup	8,251	-	8,251
General Maintenance	16,657	4,157	20,814
Reserve Study	1,025	-	1,025
Gas	42,985	-	42,985
Electricity	18,167	-	18,167
Water	38,586	-	38,586
Security	2,493	-	2,493
Holiday Decorations	4,700	-	4,700
Custodial	29,233	-	29,233
Swim Team Expenses	84,823	-	84,823
Payroll and Related Expenses	31,393	-	31,393
Clubhouse/Pool Management	30,978	-	30,978
Wall	-	1,800	1,800
Furniture	-	847	847
Drainage	-	11,953	11,953
Fence	-	3,165	3,165
Alarm Service	1,144	-	1,144
Lighting and Electrical	280	-	280
Income Tax	24	-	24
Total Expenses	567,601	24,702	592,303
Excess of Revenue Over Expenses	63,645	117,745	181,390
Association Funds Balance Beginning of Year	59,086	1,029,767	1,088,853
Interfund Transfers	(4,547)	4,547	-
Association Funds Balance End of Year	\$ 118,184	\$ 1,152,059	\$ 1,270,243

SEE INDEPENDENT AUDITORS' REPORT AND ACCOMPANYING NOTES

NEWPORT HILLS COMMUNITY ASSOCIATION
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2016

	OPERATING FUND	REPLACEMENT FUND	TOTAL
Cash Flows From Operating Activities:			
Cash Received From Members	\$ 636,361	\$ 141,790	\$ 778,151
Cash Paid To Suppliers of Goods And Services	(573,022)	(24,702)	(597,724)
Architectural Deposits Returned	(38,132)	-	(38,132)
Interest Received	-	732	732
Income Taxes Paid	(10)	-	(10)
	25,197	117,820	143,017
Cash Flows From Investing Activities:			
Maturity of Short-Term Investments	-	50,065	50,065
Cash Flows From Financing Activities:			
Interfund Transfers	(4,547)	4,547	-
	20,650	172,432	193,082
Net Increase In Cash And Cash Equivalents	20,650	172,432	193,082
Cash And Cash Equivalents At Beginning of Year	304,979	694,315	999,294
Cash And Cash Equivalents At End of Year	\$ 325,629	\$ 866,747	\$ 1,192,376

RECONCILIATION OF EXCESS OF REVENUE OVER EXPENSES
TO NET CASH PROVIDED BY OPERATING ACTIVITIES

Excess of Revenue Over Expenses	\$ 63,645	\$ 117,745	\$ 181,390
Adjustments To Reconcile Excess of Revenue Over Expenses To Net Cash Provided By Operating Activities:			
Change In Assessments Receivable	802	-	802
Change In Interest Receivable	-	75	75
Change In Prepaid Insurance	(131)	-	(131)
Change In Prepaid Expenses	(2,000)	-	(2,000)
Change In Prepaid Taxes	14	-	14
Change In Accounts Payable	(3,314)	-	(3,314)
Change In Prepaid Assessments	4,313	-	4,313
Change In Architectural Deposits	(38,132)	-	(38,132)
	25,197	117,820	143,017
Net Cash Provided By Operating Activities	\$ 25,197	\$ 117,820	\$ 143,017

SEE INDEPENDENT AUDITORS' REPORT AND ACCOMPANYING NOTES

NEWPORT HILLS COMMUNITY ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2016

NOTE 1 NATURE OF ORGANIZATION

Newport Hills Community Association was incorporated on April 13, 1970, in the state of California. It is responsible for the operation and maintenance of the common property within the development, which is located in the city of Newport Beach, California. The development consists of 532 residential units.

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Method of Accounting

The books of Newport Hills Community Association are maintained on the modified cash basis of accounting with entries made to convert them to the accrual basis for audit and tax purposes.

Fund Accounting

The Association's governing documents provide certain guidelines for governing its financial activities. To ensure observance of limitations and restrictions on the use of financial resources, the Association maintains its accounts using fund accounting. Financial resources are classified for accounting and reporting purposes in the following funds established according to their nature and purpose:

- | | |
|--------------------|---|
| Operating fund - | This fund is used to account for financial resources available for the general operations of the Association. |
| Replacement fund - | This fund is used to accumulate financial resources designated for future major repairs and replacements. |

Property and Equipment

Real property and common areas acquired by the original homeowners from the developer are owned by the individual owners in common and are not capitalized on the Association's financial statements.

Replacements and improvements to the real property and common areas also belong to the owners and are not capitalized on the Association's financial statements.

Cash Equivalents and Short-term Investments

Cash equivalents consist primarily of certificates of deposit and other securities with original maturities of 90 days or less. Certificates of deposit and other securities with original maturities over 90 days are classified as short-term investments. Cash equivalents and short-term investments are stated at cost, which approximates market value.

Use of Estimates

The Association uses estimates and assumptions in preparing these financial statements in accordance with generally accepted accounting principles. Those estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported revenues and expenses. Actual results could vary from the estimates that were used.

SEE INDEPENDENT AUDITORS' REPORT

NEWPORT HILLS COMMUNITY ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2016
(CONTINUED)

NOTE 3 REPLACEMENT FUND

The Association's governing documents require funds to be accumulated for future major repairs and replacements. Accumulated funds are held in separate accounts and are generally not available for operating purposes. It is the Association's policy to allocate interest earned on such funds to the replacement fund. Since the actual costs are dependent upon the frequency of occurrence and future costs, there is no assurance that this fund is adequate.

A study of the Association's funding program for the replacement of Association common areas, projected to December 31, 2016, indicates the Association's ideal cash replacement fund balance was \$ 1,252,659 at that date. The study recommends a 2017 contribution to the replacement fund of \$ 167,417 (\$ 26.22 per owner per month). The 2017 budgeted contribution is \$ 191,168.

The preparation of such a study involves significant estimates by the persons preparing the study, and these estimates are subject to annual revision for changing prices, circumstances and assumptions. If actual replacement costs exceed funds available, or where replacement of common areas is necessary where no fund has been previously established, the Association has the right to increase the monthly assessments, pass special assessments, or delay replacement until funds are available.

NOTE 4 INCOME TAXES

The Association is a corporation that is potentially taxable on all of its net income, including unspent member assessments. However, under state and federal filing elections, the Association may choose to be taxed only on its net non-membership income, which includes interest income.

The State of California allows qualifying homeowner associations to file an election to be taxed under special rules. Under this election, income from members (such as assessments) is exempt from taxation.

Federal law offers a similar election, which must be made annually. However, net non-membership income under this election is taxed at a flat rate of 30%. If the Association chooses to file as a regular corporation, it may still exclude from taxation its net membership income by making certain elections. Tax at the regular corporate tax rate is generally lower. Some of these elections, however, have come under IRS attack and certain issues are yet to be clarified. In 2016, the Association filed as an exempt corporation for federal taxes.

Regardless of how the Association files its taxes, non-membership income (interest) may not be offset with membership expenses (such as common area maintenance costs). That is why the Association's taxable income can be greater than its net income as recorded in the financial statements.

Federal and California income taxes have been accrued based on the taxable portion of the income reported in the accompanying financial statements.

The years open for tax authority examination are 2013 through 2016 for federal purposes and 2012 through 2016 for state purposes. Income taxes for the current year were:

2016 INCOME TAXES	FEDERAL	STATE TAX	STATE FEE	TOTAL
Income Taxes	\$ -	\$ 14	\$ 10	\$ 24
Less: Credit from prior year return	-	(247)	-	(247)
Prepaid tax	\$ -	\$ 233		\$ 233
Income tax payable			\$ 10	\$ 10

SEE INDEPENDENT AUDITORS' REPORT

NEWPORT HILLS COMMUNITY ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2016
(CONTINUED)

NOTE 5 CASH AND SHORT-TERM INVESTMENTS

The Association's cash and short-term investment balances as of December 31, 2016, were as follows:

<u>INSTITUTION</u>	<u>INTEREST RATE</u>	<u>AMOUNT</u>	<u>MATURITY DATE</u>
First Citizens Bank	-	\$ 69,085	-
First Citizens Bank	-	251,815	-
First Citizens Bank	0.05%	301,246	-
City National Bank	0.10%	252,359	-
Wells Fargo Bank	0.06%	300,475	-
Union Bank	-	4,729	-
Union Bank	0.05%	12,667	-
Santander Bank	0.05%	85,295	February 9, 2017
Alpine Bank	0.10%	100,314	November 30, 2017
Citizens Business Bank	0.10%	<u>99,703</u>	November 30, 2017
Total		<u>\$ 1,477,688</u>	

As of December 31, 2016, the Association's accounts at First Citizens Bank, City National Bank, and Wells Fargo Bank exceeded the FDIC insurance limit of \$250,000 per depositor per institution.

NOTE 6 ASSESSMENTS RECEIVABLE

Association members are subject to annual assessments (paid in semi-annual installments) to fund the Association's operating expenses, future capital acquisitions and major repairs and replacements. Assessments receivable at the balance sheet date represent assessments and other fees due from unit owners. Most owners live within Southern California and their ability to pay would be influenced by the local economy. The Association's CC & R's provide for various collection remedies for delinquent assessments including filing of liens on the owner's unit, foreclosing on the unit owner, and obtaining judgement on other assets of the unit owner.

NOTE 7 ALLOWANCE FOR DOUBTFUL ACCOUNTS

The Association uses the allowance method of recording bad debts. This method requires an annual provision for bad debts based on past or industry experience.

NOTE 8 ASSESSMENTS

During 2016, assessments were billed at a rate of \$ 595.00 per unit per month. Effective January 1, 2017, the rate increased to \$ 654.50 per unit per month.

NOTE 9 SUBSEQUENT EVENTS

The date to which events occurring after December 31, 2016, the date of the most recent balance sheet, have been evaluated for possible adjustment to the financial statements or disclosure is February 10, 2017, which is the date on which the financial statements were issued.

SEE INDEPENDENT AUDITORS' REPORT

SUPPLEMENTAL INFORMATION

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INDEPENDENT AUDITORS' REPORT ON SUPPLEMENTAL INFORMATION

Board of Directors
Newport Hills Community Association

Our report on our audit of the basic financial statements of Newport Hills Community Association for the year ended December 31, 2016 appears on page 3. That audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. Accounting principles generally accepted in the United States of America require that the 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.



Robert A. Owens, CPA A PAC

February 10, 2017

NEWPORT HILLS COMMUNITY ASSOCIATION
SUPPLEMENTAL INFORMATION ON FUTURE MAJOR REPAIRS
AND REPLACEMENTS
DECEMBER 31, 2016
(UNAUDITED)

The board of directors contracted an independent consultant who conducted a August 15, 2016 study, projected to December 31, 2016, to estimate the remaining useful lives and replacement costs of the components of common property. Funding requirements include an inflation factor of 2% and an interest rate of 1%.

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

<u>Components</u>	<u>Estimated Remaining Useful Lives</u>	<u>Estimated Current Replacement Cost</u>	<u>2017 Funding Requirement</u>	<u>Recommended Fund Balances</u>
Roofs	5 years	\$ 71,107	\$ 4,791	\$ 50,791
Painting	0 to 6 years	45,661	11,004	25,831
Lighting	0 to 12 years	40,035	2,787	27,217
Fencing/Walls	0 to 10 years	310,949	18,548	296,421
Pool/Wader	0 to 26 years	458,993	43,007	239,290
Clubhouse	0 to 13 years	406,481	31,870	249,402
Entry Softscape/Entryways	7 to 12 years	118,500	9,977	42,604
Irrigation	8 years	16,280	1,409	5,427
Landscape/Softscape	0 to 5 years	330,000	26,580	225,834
Monument Signs	2 years	17,000	1,074	15,300
N.H.D.E. Slope	16 years	120,000	7,598	24,000
Slope Drainage	15 years	50,000	3,356	12,500
Guardhouse	1 to 4 years	2,425	449	1,557
Contingency	n/a	-	4,970	36,485
		<u>\$ 1,987,431</u>	<u>\$ 167,417</u>	<u>\$ 1,252,659</u>

As shown above, the study recommends a replacement fund balance of \$1,252,659 as of December 31, 2016 and contributions to reserves of \$167,417 during 2017. The Association's replacement fund balance at December 31, 2016 was \$1,152,059 or 91.97% of the recommended fund balance.