

NEWPORT HILLS COMMUNITY ASSOCIATION

Audited Financial Statements

For The Year Ended December 31, 2018

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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, 2018, 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, 2018, 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.

Owens, Moskowitz and Associates, Inc.

February 5, 2019

NEWPORT HILLS COMMUNITY ASSOCIATION
BALANCE SHEET
DECEMBER 31, 2018

	OPERATING FUND	REPLACEMENT FUND	TOTAL
ASSETS			
Cash	\$ 594,638	\$ 872,580	\$ 1,467,218
Short-Term Investments	-	401,071	401,071
Assessments Receivable	1,705	-	1,705
Prepaid Taxes	28	-	28
Prepaid Insurance	7,650	-	7,650
Prepaid Expenses	12,000	-	12,000
Total Assets	\$ 616,021	\$ 1,273,651	\$ 1,889,672
LIABILITIES AND ASSOCIATION FUNDS			
Liabilities			
Accounts Payable	\$ 20,643	\$ -	\$ 20,643
Prepaid Assessments	215,706	-	215,706
Refundable Deposits	244,195	-	244,195
Income Taxes Payable	10	-	10
Total Liabilities	480,554	-	480,554
Commitments	-	-	-
Association Funds	135,467	1,273,651	1,409,118
Total Liabilities And Association Funds	\$ 616,021	\$ 1,273,651	\$ 1,889,672

SEE INDEPENDENT AUDITORS' REPORT AND ACCOMPANYING NOTES

NEWPORT HILLS COMMUNITY ASSOCIATION
STATEMENT OF REVENUE EXPENSES AND ASSOCIATION FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2018

	OPERATING FUND	REPLACEMENT FUND	TOTAL
REVENUE			
Assessments	\$ 513,090	\$ 182,766	\$ 695,856
Clubhouse/Recreation Center Rental Income	14,077	-	14,077
Interest Income	-	2,838	2,838
Bad Debt Recovery	4,306	-	4,306
Swim Program Income	11,300	-	11,300
Swim Team Collections	119,169	-	119,169
Other Income	6,864	-	6,864
Total Revenue	668,806	185,604	854,410
EXPENSES			
Landscape Maintenance	89,181	20,460	109,641
Management Fees	75,000	-	75,000
Administrative	19,253	-	19,253
Legal And Audit	14,269	-	14,269
Insurance	21,771	-	21,771
Pool	25,584	81,532	107,116
Rubbish Collection	5,711	-	5,711
Pest Control	1,430	9,266	10,696
Painting	-	4,400	4,400
General Maintenance	21,099	13,640	34,739
Reserve Study	700	-	700
Gas	43,712	-	43,712
Electricity	19,104	-	19,104
Water	48,401	-	48,401
Street Sweeping	4,986	-	4,986
Security	6,385	-	6,385
Custodial	29,839	-	29,839
Swim Team Expenses	101,671	-	101,671
Gate	-	7,180	7,180
Alarm Service	1,079	-	1,079
Clubhouse/Pool Management	30,321	-	30,321
Holiday Decorations	2,400	-	2,400
Payroll and Related Expenses	31,136	-	31,136
Lighting and Electrical	1,787	4,604	6,391
Income Tax	208	-	208
Total Expenses	595,027	141,082	736,109
Excess of Revenue Over Expenses	73,779	44,522	118,301
Association Funds Balance Beginning of Year, As Previously Reported	154,313	1,158,568	1,312,881
Prior Period Adjustment - Correction of Error in recording Architectural Deposits	(22,064)	-	(22,064)
Interfund Transfers	(70,561)	70,561	-
Association Funds Balance End of Year	\$ 135,467	\$ 1,273,651	\$ 1,409,118

SEE INDEPENDENT AUDITORS' REPORT AND ACCOMPANYING NOTES

NEWPORT HILLS COMMUNITY ASSOCIATION
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2018

	OPERATING FUND	REPLACEMENT FUND	TOTAL
Cash Flows From Operating Activities:			
Cash Received From Members	\$ 755,137	\$ 182,766	\$ 937,903
Cash Paid To Suppliers of Goods And Services	(597,909)	(141,082)	(738,991)
Architectural Deposits Collected	7,999	-	7,999
Interest Received	-	3,198	3,198
Income Taxes Paid	(10)	-	(10)
Net Cash Provided By Operating Activities	165,217	44,882	210,099
Cash Flows From Investing Activities:			
Maturity of Short-Term Investments	-	399,527	399,527
Cash Flows From Financing Activities:			
Interfund Transfers	(70,561)	70,561	-
Net Increase In Cash And Cash Equivalents	94,656	514,970	609,626
Cash And Cash Equivalents At Beginning of Year	499,982	357,610	857,592
Cash And Cash Equivalents At End of Year	\$ 594,638	\$ 872,580	\$ 1,467,218

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

Excess of Revenue Over Expenses	\$ 73,779	\$ 44,522	\$ 118,301
Adjustments To Reconcile Excess of Revenue Over Expenses To Net Cash Provided By Operating Activities:			
Change In Assessments Receivable	471	-	471
Change In Interest Receivable	-	360	360
Change In Prepaid Insurance	(532)	-	(532)
Change In Prepaid Expenses	(4,000)	-	(4,000)
Change In Prepaid Taxes	198	-	198
Change In Accounts Payable	1,442	-	1,442
Change In Prepaid Assessments	85,860	-	85,860
Change In Architectural Deposits	7,999	-	7,999
Net Cash Provided By Operating Activities	\$ 165,217	\$ 44,882	\$ 210,099

SEE INDEPENDENT AUDITORS' REPORT AND ACCOMPANYING NOTES

NEWPORT HILLS COMMUNITY ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2018

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, 2018
(CONTINUED)

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Revenue Recognition

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*. This guidance outlines a single, comprehensive model for accounting for revenue from contracts with customers. We adopted the standard on January 1, 2018. Our revenue is generated substantially all from assessments from member homeowners charged monthly, for services rendered monthly.

We have analyzed the provisions of the FASB's ASC Topic 606, *Revenue from Contracts with Customers*, and have concluded that no changes are necessary to conform to the new standard. Our revenue contains a single delivery element and revenue is recognized at a single point in time when ownership, risks and rewards transfer.

Credit Losses

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326)*. This guidance represents a significant change in the accounting model for credit losses by requiring immediate recognition of management's estimates of "current expected credit losses". Under the prior model, losses were recognized only as they were incurred, which FASB has noted delayed recognition of expected losses that might not yet have met the threshold of being probable. The new model is applicable to all financial instruments that are not accounted for at fair value through net income, thereby bringing consistency in accounting treatment across different types of financial instruments and requiring consideration of a broader range of variables when forming loss estimates. Although this change affects any entity holding financial instruments (ie: trade receivables or investments in debt securities) the financial services industry by its nature bears the most exposure. The effect of adoption of this standard will be to accelerate the recognition of credit losses. The effective date of this standard is for years beginning after December 15, 2021, with early adoption allowed. We do not plan an early adoption of this standard.

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, 2018, indicates the Association's ideal cash replacement fund balance was \$ 1,239,602 at that date. The study recommends a 2019 contribution to the replacement fund of \$ 191,258 (\$ 29.96 per owner per month), which the 2019 budget is following.

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.

SEE INDEPENDENT AUDITORS' REPORT

NEWPORT HILLS COMMUNITY ASSOCIATION
 NOTES TO FINANCIAL STATEMENTS
 FOR THE YEAR ENDED DECEMBER 31, 2018
 (CONTINUED)

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 2018, the Association filed as an exempt association.

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.

The Association recognizes tax benefits only to the extent that it believes it is more likely than not that its tax positions will be sustained upon examination by taxing authorities. The Association believes that all of its tax positions will be sustained if examined by taxing authorities, therefore no additional tax liabilities or related penalties and interest due to uncertain tax positions have been recorded. The Association's tax returns are subject to examination by the Internal Revenue Service for three years after they are filed, and by the California Franchise Tax Board for four years after they are filed.

Federal and California income taxes have been accrued based on the taxable portion of the income reported in the accompanying financial statements. Income taxes for the current year were:

2018 INCOME TAXES	FEDERAL	STATE TAX	STATE FEE	TOTAL
Income Taxes	\$ -	\$ 198	\$ 10	\$ 208
Less: Credit from prior year return	-	(233)	-	(233)
Prepaid tax		<u>\$ 35</u>		<u>\$ 35</u>
Income tax payable	<u>\$ -</u>		<u>\$ 10</u>	<u>\$ 10</u>

NOTE 5 ASSESSMENTS

During 2018, assessments were billed at a rate of \$ 654.00 per unit semi-annually. The rate is budgeted to remain at \$ 654.00 per unit semi-annually for 2019.

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.

SEE INDEPENDENT AUDITORS' REPORT

NEWPORT HILLS COMMUNITY ASSOCIATION
 NOTES TO FINANCIAL STATEMENTS
 FOR THE YEAR ENDED DECEMBER 31, 2018
 (CONTINUED)

NOTE 6 ASSESSMENTS RECEIVABLE (Continued)

Generally accepted accounting principles require uncollectible receivables to be accounted for using the allowance method, which requires an annual provision for doubtful accounts. As such, the allowance for doubtful accounts represents an estimate of the amount of accounts receivable that may eventually be uncollectible. The allowance was computed by adding all receivables with balances older than 180 days.

Receivable balances are written off once all collection alternatives have been exhausted and the Board of Directors has deemed them uncollectible.

NOTE 7 CASH AND SHORT-TERM INVESTMENTS

The Association's cash and short-term investment balances as of December 31, 2018, were as follows:

<u>INSTITUTION</u>	<u>INTEREST RATE</u>	<u>AMOUNT</u>	<u>MATURITY DATE</u>
First Citizens Bank	-	\$ 345,252	-
First Citizens Bank	-	244,195	-
Union Bank - Swim Team	-	5,191	-
First Citizens Bank	0.15%	388,450	-
City National Bank	0.25%	38,048	-
Vanguard Federal Money Market Fund	2.29%	401,392	-
Union Bank - Swim Team	0.08%	44,690	-
Washington Trust Bank	0.10%	200,581	February 14, 2019
Central Valley Community Bank	0.00%	200,200	June 13, 2019
Total		<u>\$ 1,867,999</u>	

As of December 31, 2018, the Association's accounts at First Citizens Bank totaled \$ 977,897 exceeding the FDIC insurance limit of \$250,000 per depositor per institution.

NOTE 8 PRIOR PERIOD ADJUSTMENT

On the audit for the year ended December 31, 2017, two checks totaling \$22,064 were voided and recorded as other income. However, these checks were actually returns of architectural deposits. A prior period adjustment of \$22,064 was made to the beginning operating fund to correct this error.

NOTE 9 SUBSEQUENT EVENTS

The date to which events occurring after December 31, 2018, the date of the most recent balance sheet, have been evaluated for possible adjustment to the financial statements or disclosure is February 5, 2019, which is the date on which the financial statements were issued.

SEE INDEPENDENT AUDITORS' REPORT

SUPPLEMENTAL INFORMATION

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, 2018 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 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.

Owens, Moskowitz and Associates, Inc.

February 5, 2019

NEWPORT HILLS COMMUNITY ASSOCIATION
 SUPPLEMENTAL INFORMATION ON FUTURE MAJOR REPAIRS
 AND REPLACEMENTS
 DECEMBER 31, 2018
 (UNAUDITED)

The board of directors contracted an independent consultant who conducted a July 2, 2018 study, projected to December 31, 2018, to estimate the remaining useful lives and replacement costs of the components of common property. Funding requirements include an inflation factor of 2.5% and an interest rate of 1.5%.

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>2019 Funding Requirement</u>	<u>Recommended Fund Balances</u>
Roofs	3 years	\$ 75,848	\$ 6,077	\$ 62,845
Painting	0 to 5 years	46,222	12,391	22,898
Lighting	3 to 15 years	35,340	2,865	17,583
Fencing/Walls	0 to 14 years	315,224	21,363	258,472
Pool/Pool Area/Wader	0 to 24 years	474,290	44,961	201,223
Clubhouse	0 to 11 years	424,453	38,449	304,755
Entry Softscape/Entryways	5 to 19 years	190,500	13,495	60,639
Irrigation	6 years	16,760	1,692	8,380
Landscape/Softscape	3 to 19 years	340,000	31,683	192,000
Monument Signs	0 years	18,000	1,052	18,000
N.H.D.E. Slope	14 years	123,000	7,824	36,900
Slope Drainage	13 years	50,000	3,224	17,500
Guardhouse	0 to 2 years	2,600	483	2,302
Contingency	n/a	-	5,699	36,105
		<u>\$ 2,112,237</u>	<u>\$ 191,258</u>	<u>\$ 1,239,602</u>

As shown above, the study recommends a replacement fund balance of \$1,239,602 as of December 31, 2018 and contributions to reserves of \$191,258 during 2019. The Association's replacement fund balance at December 31, 2018 was \$1,273,651 or 102.75% of the recommended fund balance.