

NEWPORT HILLS COMMUNITY ASSOCIATION

Audited Financial Statements

For The Year Ended December 31, 2019

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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, 2019, 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, 2019, 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.

Report on Supplementary Information

Accounting principles generally accepted in the United States of America require that the information on future major repairs and replacements of common property on page 14 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, which 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.

Owens, Moskowitz and Associates, Inc.

April 7, 2020

NEWPORT HILLS COMMUNITY ASSOCIATION
BALANCE SHEET
DECEMBER 31, 2019

	OPERATING FUND	REPLACEMENT FUND	TOTAL
ASSETS			
Cash	\$ 711,367	\$ 1,394,386	\$ 2,105,753
Assessments Receivable	131	-	131
Prepaid Insurance	8,113	-	8,113
Prepaid Expenses	5,500	-	5,500
Due From/(Due To) Other Funds	(25,548)	25,548	-
Total Assets	\$ 699,563	\$ 1,419,934	\$ 2,119,497
LIABILITIES AND ASSOCIATION FUNDS			
Liabilities			
Accounts Payable	\$ 16,705	\$ 3,930	\$ 20,635
Prepaid Assessments	214,954	-	214,954
Refundable Deposits	272,169	-	272,169
Contract Liabilities (Assessments Received In Advance - Replacement Reserve)	-	1,416,004	1,416,004
Income Taxes Payable	3,034	-	3,034
Total Liabilities	506,862	1,419,934	1,926,796
Commitments	-	-	-
Association Funds	192,701	-	192,701
Total Liabilities And Association Funds	\$ 699,563	\$ 1,419,934	\$ 2,119,497

SEE INDEPENDENT AUDITORS' REPORT AND ACCOMPANYING NOTES

NEWPORT HILLS COMMUNITY ASSOCIATION
STATEMENT OF REVENUE EXPENSES AND ASSOCIATION FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2019

	OPERATING FUND	REPLACEMENT FUND	TOTAL
REVENUE			
Assessments	\$ 504,598	\$ 48,905	\$ 553,503
Clubhouse/Recreation Center Rental Income	22,200	-	22,200
Interest Income	-	14,786	14,786
Swim Program Income	12,080	-	12,080
Swim Team Collections	109,433	-	109,433
Other Income	8,267	-	8,267
Total Revenue	656,578	63,691	720,269
EXPENSES			
Landscape Maintenance	101,782	-	101,782
On-site Manager	73,500	-	73,500
Administrative	20,202	-	20,202
Legal And Audit	6,860	-	6,860
Insurance	18,028	-	18,028
Pool	23,316	1,790	25,106
Rubbish Collection	5,687	-	5,687
Pest Control	1,150	-	1,150
Painting	-	6,440	6,440
General Maintenance	22,178	14,203	36,381
Reserve Study	1,100	-	1,100
Gas	52,924	-	52,924
Electricity	19,625	-	19,625
Water	44,453	-	44,453
Security	4,986	2,023	7,009
Cable/Telephone/Internet	8,433	-	8,433
Custodial	27,750	-	27,750
Swim Team Expenses	94,913	-	94,913
Clubhouse/Pool Management	32,269	-	32,269
Payroll and Related Expenses	32,688	-	32,688
Cabinets	-	16,500	16,500
Concrete	-	2,105	2,105
Fence	-	9,915	9,915
Lighting and Electrical	3,466	6,500	9,966
Restrooms	-	4,215	4,215
Income Tax	4,034	-	4,034
Total Expenses	599,344	63,691	663,035
Excess of Revenue Over Expenses	57,234	-	57,234
Association Funds Balance Beginning of Year	135,467	-	135,467
Association Funds Balance End of Year	\$ 192,701	\$ -	\$ 192,701

SEE INDEPENDENT AUDITORS' REPORT AND ACCOMPANYING NOTES

NEWPORT HILLS COMMUNITY ASSOCIATION
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2019

Cash Flows From Operating Activities:			
Cash Received From Members	\$ 657,400	\$ 191,258	\$ 848,658
Cash Paid To Suppliers of Goods And Services	(593,211)	(59,761)	(652,972)
Architectural Deposits Collected	27,974	-	27,974
Interest Received	-	14,786	14,786
Income Taxes Paid	(982)	-	(982)
Net Cash Provided By (Used In) Operating Activities	91,181	146,283	237,464
Cash Flows From Investing Activities:			
Maturity (Purchase) of Short-Term Investments	-	401,071	401,071
Cash Flows From Financing Activities:			
Interfund Borrowings	25,548	(25,548)	-
Net Increase (Decrease) In Cash And Cash Equivalents	116,729	521,806	638,535
Cash And Cash Equivalents At Beginning of Year	594,638	872,580	1,467,218
Cash And Cash Equivalents At End of Year	\$ 711,367	\$ 1,394,386	\$ 2,105,753

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

Adjustments To Reconcile Excess of Revenue Over Expenses To Net Cash Provided By Operating Activities:

Change In Assessments Receivable	1,574	-	1,574
Change In Prepaid Insurance	(463)	-	(463)
Change In Prepaid Expenses	6,500	-	6,500
Change In Prepaid Taxes	28	-	28
Change In Accounts Payable	(3,938)	3,930	(8)
Change In Contract Liabilities	-	142,353	142,353
Change In Prepaid Assessments	(752)	-	(752)
Change In Architectural Deposits	27,974	-	27,974
Change In Income Tax Payable	3,024	-	3,024
Net Cash Provided By Operating Activities	\$ 91,181	\$ 146,283	\$ 237,464

SEE INDEPENDENT AUDITORS' REPORT AND ACCOMPANYING NOTES

NEWPORT HILLS COMMUNITY ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2019

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.

The Association maintains bank accounts at various financial institutions. During the course of the year, the accounts may fluctuate over the FDIC insured amount of \$250,000.

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, 2019
 (CONTINUED)

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Member Assessments

Association members are subject to semi-annual assessments to provide funds for the Association's operating expenses and major repairs and replacements. Assessment revenue is recognized as the related performance obligations are satisfied at transaction amounts expected to be collected. The Association's performance obligations related to its operating assessments is satisfied over time on a daily pro-rata basis using the input method. The performance obligations related to the replacement fund assessments are satisfied when these funds are expended for their designated purpose. Assessments receivable at the balance sheet date are stated at the amounts expected to be collected from outstanding assessments from unit owners. The Association's policy is to retain legal counsel and place liens on the properties of homeowners whose assessments are thirty days or more delinquent. Any excess assessments at year end are retained by the Association for use in the succeeding year. At December 31, 2019, the Association had delinquent assessments of \$131. It is the opinion of the board of directors that the Association will ultimately prevail against homeowners with delinquent assessments and, accordingly, no allowance for uncollectible accounts is deemed necessary.

The Association treats uncollectible assessments as variable consideration. Methods, inputs, and assumptions used to evaluate whether an estimate of variable consideration is constrained include consideration of past experience and susceptibility to factors outside the Association's control. Assessments receivable as of the beginning and end of the year were \$1,705 and \$131, respectively.

Contract Liabilities (Assessments received in advance-replacement fund)

The Association recognizes revenue from members as the related performance obligations are satisfied. A contract liability (assessments received in advance-replacement fund) is (are) recorded when the Association has the right to receive payment in advance of the satisfaction of performance obligations related to replacement reserve assessments. The activity in contract liabilities (assessments received in advance-replacement fund) during 2019 is as follows:

Assessments Budgeted for Replacement Reserve	191,258
Revenue Released to Match Reserve Expenses	<u>(48,905)</u>
Contract Liabilities, at December 31, 2019	<u>\$ 1,416,004</u>

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, 2023, with early adoption allowed. We do not plan an early adoption of this standard.

SEE INDEPENDENT AUDITORS' REPORT

NEWPORT HILLS COMMUNITY ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2019
(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. We have analyzed the provisions of the FASB's ASC Topic 606, *Revenue from Contracts with Customers*, and have concluded that the changes detailed in Note 6 are required.

NOTE 3 FUTURE MAJOR REPAIRS AND REPLACEMENTS

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, 2019, indicates the Association's ideal cash replacement fund balance was \$ 1,265,768 at that date. The study recommends a 2020 contribution to the replacement fund of \$ 188,991 (\$ 29.60 per owner per month). The 2020 budgeted contribution is \$ 191,486.

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 2019, the Association filed as a regular corporation for federal taxes, since it had an excess of maintenance expenses over membership source income. That excess may be carried over to future periods to offset future membership source income when the Association files as a regular corporation. This election is not related to the issues involved in the recent IRS audits.

SEE INDEPENDENT AUDITORS' REPORT

NEWPORT HILLS COMMUNITY ASSOCIATION
 NOTES TO FINANCIAL STATEMENTS
 FOR THE YEAR ENDED DECEMBER 31, 2019
 (CONTINUED)

NOTE 4 INCOME TAXES (Continued)

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.

Accounting principles generally accepted in the United States of America require management to evaluate tax positions taken by the Association and recognize a tax liability if the Association has taken an uncertain position that more likely than not would not be sustained upon examination by the IRS. Management has analyzed the tax positions taken by the Association and has concluded that as of December 31, 2019, there are no uncertain positions taken or expected to be taken that would require recognition of a liability or disclosure in the financial statements. The Association is subject to routine audits by taxing jurisdictions; however, there are currently no audits in progress. The Association's management believes it is no longer subject to income tax examinations for years prior to 2015.

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:

Income Taxes	\$ 2,774	\$ 1,250	\$ 10	\$ 4,034
Less: Credit from prior year return	-	(28)	-	(28)
Less: Estimated payments	-	(972)	-	(972)
Income tax payable	\$ 2,774	\$ 250	\$ 10	\$ 3,034

NOTE 5 ASSESSMENTS

During 2019, 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 2020.

NOTE 6 FASB ASC 606 NEW ACCOUNTING GUIDANCE IMPLEMENTATION

The Financial Accounting Standards Board (FASB) issued new guidance that created Topic 606, *Revenue from Contracts with Customers*, in the Accounting Standards Codification (ASC). Topic 606 supersedes the revenue recognition requirements in FASB ASC 972-605, *Real Estate—Common Interest Realty Associations, Revenue Recognition*, and requires the recognition of revenue when promised goods or services are transferred to customers in an amount that reflects the consideration to which a CIRA expects to be entitled in exchange for those goods or services.

The Association adopted the requirements of new guidance as of January 1, 2018, using the modified retrospective method of transition, which requires that the cumulative effect of the changes related to the adoption be charged to beginning fund balance. The Association applied the new guidance using the practical expedient provided in Topic 606 that allows the guidance to be applied only to contracts that were not complete as of January 1, 2018. Adoption of the new guidance resulted in changes to our accounting policies for assessment revenue and contract liabilities related to the replacement fund, as previously described.

The effect of the adoption is a decrease in 2019 assessments by \$142,353 and a recording of a contract liability (assessments received in advance-replacement fund) at December 31, 2019, of \$1,416,004. The Association has no customer contract modifications that had an effect on the Association's transition to the new guidance.

SEE INDEPENDENT AUDITORS' REPORT

NEWPORT HILLS COMMUNITY ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2019
(CONTINUED)

NOTE 7 INTERFUND ACCOUNT

The interfund account represents the amount one fund owes another fund. Various scenarios may cause this situation which include, but are not limited to, one fund paying the expenses of another fund, one fund borrowing from another fund, or the operating fund not paying the full annual budgeted contribution amount to the replacement fund.

NOTE 8 RELATED PARTY TRANSACTIONS

During 2019, the Association's on-site manager paid for miscellaneous maintenance and administrative expenses and reserve expenses on behalf of the Association and received total reimbursements of \$19,016.

NOTE 9 CONTINGENCY

In 2020, domestic and international economies face uncertainty related to the impact of the COVID-19 disease. The Association may be adversely affected through disruptions in maintenance and financial strain on the members due to job lay-offs which could cause a decrease in revenue. Management is currently evaluating the impact it will have on future operations. Currently, we are not able to estimate a resulting loss or range of loss, if any.

NOTE 10 SUBSEQUENT EVENTS

The date to which events occurring after December 31, 2019, the date of the most recent balance sheet, have been evaluated for possible adjustment to the financial statements or disclosure is April 7, 2020, which is the date on which the financial statements were issued.

SEE INDEPENDENT AUDITORS' REPORT

SUPPLEMENTAL INFORMATION

NEWPORT HILLS COMMUNITY ASSOCIATION
 SUPPLEMENTAL INFORMATION ON FUTURE MAJOR REPAIRS
 AND REPLACEMENTS
 DECEMBER 31, 2019
 (UNAUDITED)

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>2020 Funding Requirement</u>	<u>Recommended Fund Balances</u>
Clubhouse Roofs	4 years	\$ 78,218	\$ 6,854	\$ 62,174
Painting	0 to 5 years	66,437	10,272	32,271
Lighting	4 to 14 years	39,213	3,627	18,325
Fencing/Walls	0 to 13 years	328,313	24,508	266,877
Pool/Pool Area/Wader	0 to 18 years	471,216	50,766	207,545
Clubhouse	0 to 20 years	455,376	39,663	258,085
Entry Softscape/Entryways	4 to 18 years	192,300	16,593	71,635
Irrigation	5 years	17,160	2,113	10,010
Landscape/Softscape	2 to 18 years	340,000	13,612	217,333
Monument Signs	0 years	18,000	1,278	18,000
N.H.D.E. Slope	13 years	126,000	9,771	44,100
Slope Drainage	12 years	50,000	3,924	20,000
Guardhouse	0 to 1 year	2,700	424	2,546
Contingency	n/a	-	5,586	36,867
		<u>\$ 2,184,933</u>	<u>\$ 188,991</u>	<u>\$ 1,265,768</u>

As shown above, the study recommends a cash replacement balance of \$1,265,768 as of December 31, 2019 and contributions to reserves of \$188,991 during 2020. The Association's total replacement fund total assets at December 31, 2019 were \$1,416,004 or 111.87% of the recommended balance.