

NEWPORT HILLS COMMUNITY ASSOCIATION

Audited Financial Statements

For The Year Ended December 31, 2017

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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, 2017, 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, 2017, 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.

Owens, Moskowitz and Associates, Inc.

April 23, 2018

NEWPORT HILLS COMMUNITY ASSOCIATION
BALANCE SHEET
DECEMBER 31, 2017

	OPERATING FUND	REPLACEMENT FUND	TOTAL
ASSETS			
Cash	\$ 499,982	\$ 357,610	\$ 857,592
Short-Term Investments	-	800,598	800,598
Assessments Receivable	6,482	-	6,482
Less: Allowance For Doubtful Accounts	(4,306)	-	(4,306)
Interest Receivable	-	360	360
Prepaid Taxes	226	-	226
Prepaid Insurance	7,118	-	7,118
Prepaid Expenses	8,000	-	8,000
Total Assets	\$ 517,502	\$ 1,158,568	\$ 1,676,070
LIABILITIES AND ASSOCIATION FUNDS			
Liabilities			
Accounts Payable	\$ 19,201	\$ -	\$ 19,201
Prepaid Assessments	129,846	-	129,846
Architectural Deposits	214,132	-	214,132
Income Taxes Payable	10	-	10
Total Liabilities	363,189	-	363,189
Commitments	-	-	-
Association Funds	154,313	1,158,568	1,312,881
Total Liabilities And Association Funds	\$ 517,502	\$ 1,158,568	\$ 1,676,070

SEE INDEPENDENT AUDITORS' REPORT AND ACCOMPANYING NOTES

NEWPORT HILLS COMMUNITY ASSOCIATION
STATEMENT OF REVENUE EXPENSES AND ASSOCIATION FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2017

	OPERATING FUND	REPLACEMENT FUND	TOTAL
REVENUE			
Assessments	\$ 505,220	\$ 191,168	\$ 696,388
Clubhouse/Recreation Center Rental Income	9,950	-	9,950
Interest Income	-	584	584
Swim Program	7,251	-	7,251
Swim Team Collection	119,701	-	119,701
Other Income	40,062	-	40,062
Total Revenue	682,184	191,752	873,936
EXPENSES			
Landscape Maintenance	94,853	130,610	225,463
Management Fees	71,576	-	71,576
Administrative	21,147	-	21,147
Legal And Audit	9,280	-	9,280
Insurance	26,825	-	26,825
Bad Debt	3,734	-	3,734
Pool	25,546	35,032	60,578
Rubbish Collection	4,751	-	4,751
Pest Control	215	-	215
General Maintenance	19,209	34,093	53,302
Reserve Study	700	-	700
Gas	39,208	-	39,208
Electricity	19,210	-	19,210
Water	37,251	-	37,251
Security	5,195	-	5,195
Custodial	28,643	-	28,643
Swim Team Expenses	104,736	-	104,736
Payroll and Related Expenses	30,889	-	30,889
Alarm Service	840	-	840
Clubhouse/Pool Management	28,906	-	28,906
Fence	-	45,815	45,815
Holiday Decorations	2,350	-	2,350
Lighting and Electrical	2,695	1,725	4,420
Telephone/Cable/Internet	6,247	-	6,247
Income Tax	17	-	17
Total Expenses	584,023	247,275	831,298
Excess (Deficiency) of Revenue Over Expenses	98,161	(55,523)	42,638
Association Funds Balance Beginning of Year	118,184	1,152,059	1,270,243
Interfund Transfers	(62,032)	62,032	-
Association Funds Balance End of Year	\$ 154,313	\$ 1,158,568	\$ 1,312,881

SEE INDEPENDENT AUDITORS' REPORT AND ACCOMPANYING NOTES

NEWPORT HILLS COMMUNITY ASSOCIATION
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2017

	OPERATING FUND	REPLACEMENT FUND	TOTAL
Cash Flows From Operating Activities:			
Cash Received From Members	\$ 803,969	\$ 191,168	\$ 995,137
Cash Paid To Suppliers of Goods And Services	(576,884)	(247,275)	(824,159)
Architectural Deposits Collected	9,310	-	9,310
Interest Received	-	224	224
Income Taxes Paid	(10)	-	(10)
Net Cash Provided By (Used In) Operating Activities	236,385	(55,883)	180,502
Cash Flows From Investing Activities:			
Purchase of Short-Term Investments	-	(515,286)	(515,286)
Cash Flows From Financing Activities:			
Interfund Transfers	(62,032)	62,032	-
Net Increase (Decrease) In Cash And Cash Equivalents	174,353	(509,137)	(334,784)
Cash And Cash Equivalents At Beginning of Year	325,629	866,747	1,192,376
Cash And Cash Equivalents At End of Year	\$ 499,982	\$ 357,610	\$ 857,592

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

Excess (Deficiency) of Revenue Over Expenses	\$ 98,161	\$ (55,523)	\$ 42,638
Adjustments To Reconcile Excess (Deficiency) of Revenue Over Expenses To Net Cash Provided By Operating Activities:			
Change In Assessments Receivable	335	-	335
Change In Interest Receivable	-	(360)	(360)
Change In Prepaid Insurance	(246)	-	(246)
Change In Prepaid Expenses	(1,000)	-	(1,000)
Change In Prepaid Taxes	7	-	7
Change In Accounts Payable	4,634	-	4,634
Change In Prepaid Assessments	125,184	-	125,184
Change In Architectural Deposits	9,310	-	9,310
Net Cash Provided By (Used In) Operating Activities	\$ 236,385	\$ (55,883)	\$ 180,502

SEE INDEPENDENT AUDITORS' REPORT AND ACCOMPANYING NOTES

NEWPORT HILLS COMMUNITY ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2017

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, 2017
 (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, 2017, indicates the Association's ideal cash replacement fund balance was \$ 1,149,951 at that date. The study recommends a 2018 contribution to the replacement fund of \$ 170,189 (\$ 26.66 per owner per month). The 2018 budgeted contribution is \$ 182,766.

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 2017, 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.

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 2014 through 2017 for federal purposes and 2013 through 2017 for state purposes. Income taxes for the current year were:

2017 INCOME TAXES	<u>FEDERAL</u>	<u>STATE TAX</u>	<u>STATE FEE</u>	<u>TOTAL</u>
Income Taxes	\$ -	\$ 7	\$ 10	\$ 17
Less: Credit from prior year return	-	(233)	-	(233)
Prepaid tax	\$ -	\$ 226		\$ 226
Income tax payable			\$ 10	\$ 10

SEE INDEPENDENT AUDITORS' REPORT

NEWPORT HILLS COMMUNITY ASSOCIATION
 NOTES TO FINANCIAL STATEMENTS
 FOR THE YEAR ENDED DECEMBER 31, 2017
 (CONTINUED)

NOTE 5 CASH AND SHORT-TERM INVESTMENTS

The Association's cash and short-term investment balances as of December 31, 2017, were as follows:

INSTITUTION	INTEREST RATE	AMOUNT	MATURITY DATE
First Citizens Bank	-	\$ 184,257	-
First Citizens Bank	-	296,031	-
First Citizens Bank	0.05%	306,956	-
City National Bank	0.05%	37,981	-
Union Bank	-	19,694	-
Union Bank	0.05%	12,673	-
Northern Bank & Trust Company	0.10%	200,381	February 15, 2018
United Business Bank	0.10%	200,000	June 14, 2018
Bank of the West	0.10%	200,000	August 16, 2018
Citizens Business Bank	0.10%	200,217	November 29, 2018
Total		\$ 1,658,190	

As of December 31, 2017, the Association's accounts at First Citizens Bank totaled \$ 787,244 exceeding 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 2017, assessments were billed at a rate of \$ 654.50 per unit semi-annually. Effective January 1, 2018, the rate decreased to \$ 654.00 per unit semi-annually.

NOTE 9 SUBSEQUENT EVENTS

The date to which events occurring after December 31, 2017, the date of the most recent balance sheet, have been evaluated for possible adjustment to the financial statements or disclosure is April 23, 2018, which is the date on which the financial statements were issued.

SEE INDEPENDENT AUDITORS' REPORT

SUPPLEMENTAL INFORMATION

OWENS, MOSKOWITZ AND ASSOCIATES, INC.

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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, 2017 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.

Owens, Moskowitz and Associates, Inc.

Owens, Moskowitz and Associates, Inc.

April 23, 2018

NEWPORT HILLS COMMUNITY ASSOCIATION
 SUPPLEMENTAL INFORMATION ON FUTURE MAJOR REPAIRS
 AND REPLACEMENTS
 DECEMBER 31, 2017
 (UNAUDITED)

The board of directors contracted an independent consultant who conducted a September 15, 2017 study, projected to December 31, 2017, 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.

Components	Estimated Remaining Useful Lives	Estimated Current Replacement Cost	2018 Funding Requirement	Recommended Fund Balances
Roofs	4 years	\$ 73,478	\$ 5,131	\$ 56,683
Painting	0 to 5 years	46,246	11,155	34,001
Lighting	4 to 11 years	37,971	2,721	20,052
Fencing/Walls	0 to 15 years	312,857	19,170	259,707
Pool/Pool Area/Wader	0 to 25 years	469,525	40,042	179,182
Clubhouse	0 to 12 years	412,418	33,462	280,152
Entry Softscape/Entryways	6 to 11 years	118,500	10,555	49,821
Irrigation	7 years	16,280	1,464	6,783
Landscape/Softscape	4 to 20 years	337,930	27,968	166,667
Monument Signs	1 year	17,200	1,125	16,340
N.H.D.E. Slope	15 years	120,000	8,274	30,000
Slope Drainage	14 years	50,000	3,671	15,000
Guardhouse	0 to 3 years	2,500	422	2,069
Contingency	n/a	-	5,033	33,494
		<u>\$ 2,014,905</u>	<u>\$ 170,189</u>	<u>\$ 1,149,951</u>

As shown above, the study recommends a replacement fund balance of \$1,149,951 as of December 31, 2017 and contributions to reserves of \$170,189 during 2018. The Association's replacement fund balance at December 31, 2017 was \$1,158,208 or 100.72% of the recommended fund balance.