

DATE: May 10, 2012

TO: All Homeowners  
Cypress Home Owners Association

FROM: The Board of Directors  
Cypress Home Owners Association

RE: Annual Audit as of December 31, 2011

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In accordance with California Civil Code Section 1365, the Cypress Home Owners Association Board of Directors is submitting to the Association's Homeowners a copy of the Financial Audit for the fiscal year ending December 31, 2011. The Association's independent auditor, Schonwit & Company, CPA, performed this Annual Audit. California Law requires that a copy of the Audit be distributed to the membership on an annual basis.

The Audit entails a review of all financial documents, accounting procedures and practices to provide a statement for the Cypress Home Owners Association's financial position as of December 31, 2011.

Please review the enclosed information. Homeowners are encouraged to retain the Audit in your permanent records for Cypress Home Owners Association.



CYPRESS HOME OWNERS ASSOCIATION  
COMPARATIVE FINANCIAL STATEMENTS  
DECEMBER 31, 2011 AND 2010

CYPRESS HOME OWNERS ASSOCIATION

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# Schonwit & Company

## Certified Public Accountants

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### INDEPENDENT AUDITORS' REPORT

To the Owners  
Cypress Home Owners Association

We have audited the accompanying balance sheet of Cypress Home Owners Association, as of December 31, 2011, and the related statements of revenues, expenses and changes in fund balances, and cash flows for the year then ended. These financial statements are the responsibility of the Association's management. Our responsibility is to express an opinion on these financial statements based on our audit. The prior year summarized comparative information is presented for comparative purposes only and has been extracted from the Cypress Home Owners Association's financial statements presented by fund for 2010 on which we expressed an unqualified opinion in our report dated April 5, 2011.

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 includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

A current 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 accompanying financial statements referred to above present fairly, in all material respects, the financial position of Cypress Home Owners Association as of December 31, 2011, 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.

The supplementary information on future major repairs and replacements that accompanies the basic financial statements is not a required part of the basic financial statements but is supplementary information required by the American Institute of Certified Public Accountants. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

  
SCHONWIT & COMPANY

March 19, 2012

CYPRESS HOME OWNERS ASSOCIATION  
BALANCE SHEET  
AS OF DECEMBER 31, 2011  
(WITH COMPARATIVE TOTALS FOR 2010)

	<u>2011</u>			<u>2010</u>
	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>Total</u>	<u>Total</u>
<b>ASSETS</b>				
Cash and cash equivalents [Note 7]	\$ 128,803	\$ 322,996	\$ 451,799	\$ 368,905
Member assessments receivable, less allowance for doubtful collection of \$93,200 at 12/31/11 and \$78,800 at 12/31/10	17,112	--	17,112	30,382
Investments [Note 8]	--	50,697	50,697	50,193
Accrued interest receivable	--	19	19	32
Prepaid insurance	65,557	--	65,557	26,560
Prepaid taxes	2,418	--	2,418	--
Due (to)/from fund	<u>(62,711)</u>	<u>62,711</u>	<u>--</u>	<u>--</u>
Total Assets	<u>\$ 151,179</u>	<u>\$ 436,423</u>	<u>\$ 587,602</u>	<u>\$ 476,072</u>
<b>LIABILITIES</b>				
Accounts payable	\$ 17,865	\$ --	\$ 17,865	\$ 17,280
Prepaid assessments	7,703	--	7,703	17,534
Income taxes payable	<u>10</u>	<u>--</u>	<u>10</u>	<u>1,269</u>
Total Liabilities	25,578	--	25,578	36,083
<b>FUND BALANCES</b>	<u>125,601</u>	<u>436,423</u>	<u>562,024</u>	<u>439,989</u>
<b>TOTAL LIABILITIES AND FUND BALANCES</b>	<u>\$ 151,179</u>	<u>\$ 436,423</u>	<u>\$ 587,602</u>	<u>\$ 476,072</u>

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

CYPRESS HOME OWNERS ASSOCIATION  
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND BALANCES  
FOR THE YEAR ENDED DECEMBER 31, 2011  
(WITH COMPARATIVE TOTALS FOR 2010)

	2011			2010
	Operating Fund	Replacement Fund	Total	Total
<b>REVENUES</b>				
Member assessments	\$ 558,200	\$ 266,800	\$ 825,000	\$ 825,000
Interest	--	1,754	1,754	665
Other income	13,316	--	13,316	21,690
Total Revenues	<u>571,516</u>	<u>268,554</u>	<u>840,070</u>	<u>847,355</u>
<b>EXPENSES</b>				
Utilities:				
Electricity	33,523	--	33,523	34,147
Water	54,937	--	54,937	46,755
Gas	1,565	--	1,565	2,845
Refuse	60,034	--	60,034	53,169
Maintenance:				
Landscape maintenance and supplies	83,353	--	83,353	83,062
Irrigation repairs	1,659	--	1,659	3,410
Tree maintenance	7,630	--	7,630	10,095
Pool service, supplies and repairs	20,952	4,033	24,985	26,381
Janitorial service and supplies	7,460	--	7,460	7,792
Pest control	5,058	--	5,058	2,187
Roof repairs	13,818	42,264	56,082	86,652
Plumbing repairs	9,186	--	9,186	20,087
Other common area maintenance	20,469	--	20,469	14,845
Painting	--	94,675	94,675	108,275
Wood repairs	--	46,350	46,350	43,375
Asphalt work	--	4,373	4,373	--
Administrative:				
Insurance	141,328	--	141,328	151,328
Management fees	41,484	--	41,484	41,484
Professional fees	5,018	--	5,018	7,861
Income taxes [Note 4]	298	--	298	2,269
Postage and printing expense	4,575	--	4,575	3,997
Other administrative expenses	3,325	--	3,325	18,341
Bad debt expense	10,668	--	10,668	30,165
Total Expenses	<u>526,340</u>	<u>191,695</u>	<u>718,035</u>	<u>798,522</u>
<b>EXCESS OF REVENUES OVER EXPENSES</b>	45,176	76,859	122,035	48,833
<b>Beginning Fund Balances</b>	<u>80,425</u>	<u>359,564</u>	<u>439,989</u>	<u>391,156</u>
<b>Ending Fund Balances</b>	<u>\$ 125,601</u>	<u>\$ 436,423</u>	<u>\$ 562,024</u>	<u>\$ 439,989</u>

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

CYPRESS HOME OWNERS ASSOCIATION  
STATEMENT OF CASH FLOWS  
FOR THE YEAR ENDED DECEMBER 31, 2011  
(WITH COMPARATIVE TOTALS FOR 2010)

	<u>2011</u>			<u>2010</u>
	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>Total</u>	<u>Total</u>
<b>Excess of revenues over expenses:</b>	\$ 45,176	\$ 76,859	\$ 122,035	\$ 48,833
Adjustments to reconcile excess of revenues over expenses to net cash provided by operating activities:				
Decrease in member assessments receivable	13,270	--	13,270	9,449
(Increase)/decrease in accrued interest receivable	--	13	13	(32)
Increase in prepaid insurance	(38,997)	--	(38,997)	(6,355)
(Increase)/decrease in prepaid taxes	(2,418)	--	(2,418)	2,852
Increase/(decrease) in accounts payable	1,456	(871)	585	6,063
Increase/(decrease) in prepaid assessments	(9,831)	--	(9,831)	1,010
Increase/(decrease) in income taxes payable	(1,259)	--	(1,259)	1,259
Net cash provided by operating activities	<u>7,397</u>	<u>76,001</u>	<u>83,398</u>	<u>63,079</u>
Cash provided by investing activities:				
Acquisition of certificates of deposit	--	(50,697)	(50,697)	(50,193)
Maturity of certificates of deposit	--	50,193	50,193	--
Net cash flows from investing activities	<u>--</u>	<u>(504)</u>	<u>(504)</u>	<u>(50,193)</u>
Net increase in cash	7,397	75,497	82,894	12,886
Cash at beginning of year	<u>121,406</u>	<u>247,499</u>	<u>368,905</u>	<u>356,019</u>
Cash at end of year	<u>\$ 128,803</u>	<u>\$ 322,996</u>	<u>\$ 451,799</u>	<u>\$ 368,905</u>

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

CYPRESS HOME OWNERS ASSOCIATION  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2011

NOTE 1. ORGANIZATION

Cypress Home Owners Association [the Association] is a statutory homeowners association which was organized as a non-profit mutual benefit corporation in February 1965. The purpose of the Association is primarily to maintain, preserve and control the common areas of the Association. The Association consists of 250 residential units and is located in Cypress, California.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Principles of Accounting - The books and records for the Association are maintained the 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, 2011, 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 and investment 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 March 19, 2012, 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, 2010, from which the summarized information was derived.



CYPRESS HOME OWNERS ASSOCIATION  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2011

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, 2011, the Association elected to file as a regular corporation using certain provisions available to membership organizations. 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, 2011, the federal and California income tax expense was \$182 and \$116, 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, 2011 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, 2011, the Association has recorded an allowance for uncollectible assessments of \$93,200. This allowance represents an estimated amount which was calculated using historical collection information.

For the year ended December 31, 2011, the Association's monthly assessment was \$275 per unit. For 2012, the monthly assessment has been raised to \$285 per unit.

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.

CYPRESS HOME OWNERS ASSOCIATION  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2011

NOTE 6. REPLACEMENT FUNDING PROGRAM – (CONTINUED)

An independent study of the Association's replacement funding program, which was conducted in November 2011, indicates that the Association is underfunded. Accordingly the study recommends a contribution to the replacement fund of approximately \$230,381 for 2012. 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, 2011, the Association funded \$266,800 from assessments to the replacement fund. The 2012 budget includes a provision for replacement funding of \$290,800. 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, 2011 and 2010, the Association maintained cash balances at the following institutions:

<u>Operating Fund:</u>	<u>2011</u>	<u>2010</u>
City National Bank - checking	<u>\$ 128,803</u>	<u>\$ 121,406</u>
 <u>Replacement Fund:</u>		
City National Bank - money market	\$ 147,108	\$ 247,499
State Farm Bank - money market	<u>175,888</u>	<u>--</u>
Total Cash - Replacement Fund	<u>\$ 322,996</u>	<u>\$ 247,499</u>

CYPRESS HOME OWNERS ASSOCIATION  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2011

NOTE 8. INVESTMENTS

The Association's investments consist of certificates of deposit with original maturities over 90 days. Investment income from these investments is recorded when earned or accrued. The investments are considered to be held to maturity and are carried at cost, which approximates the fair value.

At December 31, 2011 and 2010, the Association's investment is as follows:

<u>Replacement Fund:</u>	<u>2011</u>	<u>2010</u>
State Farm Bank - 1.15%, 8/12/11	<u>\$ 50,697</u>	<u>\$ 50,193</u>

NOTE 9. SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

Cash paid for income taxes amounted to \$3,965 for the year ended December 31, 2011. No interest was paid and there were no non-cash investing or financing transactions during the year.

CYPRESS HOME OWNERS ASSOCIATION  
 REQUIRED SUPPLEMENTARY INFORMATION  
 ON FUTURE MAJOR REPAIRS & REPLACEMENTS  
 AS OF DECEMBER 31, 2011  
 (UNAUDITED)

An independent reserve study was conducted in November 2011 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 independent reserve analyst. The estimates were based on current replacement costs adjusted for an annual inflation rate of 3.0%. 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%.

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>2012 Recommended Funding Requirement</u>	<u>Study's Recommended Fund Balance</u>
Painting	0-6 years	\$ 443,254	\$ 94,034	\$ 102,774
Roofs	0-49 years	2,295,541	105,879	844,363
Pools/spas	0-10 years	63,469	8,367	27,169
Fences/gates	4-8 years	36,771	2,649	27,254
Irrigation controllers	3 years	108,150	7,791	91,928
HVAC - clubhouse	4 years	12,742	918	10,192
Tot lot equipment	1 year	37,139	3,567	34,663
Decks	9 years	16,223	1,169	8,922
Clubhouse furniture	8 years	3,300	238	1,980
Clubhouse interior	2-10 years	34,500	3,509	33,147
Concrete	1 year	5,405	1,948	4,056
Water heaters - clubhouse	0 years	2,596	312	2,596
	Total	<u>\$ 3,059,090</u>	<u>\$ 230,381</u>	<u>\$ 1,189,044</u>
Replacement Fund balance at 12/31/11:				<u>\$ 436,423</u>