



Member:
American Institute
of Certified Public
Accountants

Member:
California Society
of Certified Public
Accountants

23041 Avenida de la Carlota, Suite 310
Laguna Hills, CA 92653

Phone: (949) 586-6640
Fax: (949) 586-6137

To the Board of Directors and Members of
Cypress Home Owners Association

INDEPENDENT AUDITOR'S REPORT

Report on the Financial Statements

We have audited the accompanying financial statements of Cypress Home Owners Association, which comprise the balance sheet as of December 31, 2019, and the related statements of revenues, expenses, and changes in fund balances, 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 Cypress Home Owners Association as of December 31, 2019, 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 of America.

Board of Directors and Members
Cypress Home Owners Association

Emphasis of Matter on Future Major Repairs and Replacements

Our audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. We have not applied procedures to determine whether the funds designated for future major repairs and replacements as discussed in Note 3 are adequate to meet such future costs because that determination is outside the scope of our audit. Our opinion is not modified with respect to this matter.

Disclaimer of Opinion on Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the required supplementary information on future major repairs and replacements on page 10 be presented to supplement the basic financial statements. Such information, although not 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 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.

Inouye, Shively & Klatt CPAs, LLP

Inouye, Shively, & Klatt

Laguna Hills, CA
April 22, 2020

CYPRESS HOME OWNERS ASSOCIATION
BALANCE SHEET
AS OF DECEMBER 31, 2019

	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>Total</u>
Assets			
Cash and cash equivalents	\$ 488,275	\$ 193,935	\$ 682,210
Investments	-	1,013,405	1,013,405
Assessments receivable	37,938	-	37,938
Allowance for doubtful accounts	(23,000)	-	(23,000)
Other receivables	-	3,909	3,909
Accrued interest receivable	-	6,095	6,095
Prepaid insurance	38,768	-	38,768
Interfund account	(82,212)	82,212	-
Total assets	<u>459,769</u>	<u>1,299,556</u>	<u>1,759,325</u>
Liabilities			
Accounts payable	50,260	8,333	58,593
Prepaid/deferred assessments	27,058	1,291,223	1,318,281
Other payables	2,905	-	2,905
Income taxes payable	1,318	-	1,318
	<u>81,541</u>	<u>1,299,556</u>	<u>1,381,097</u>
Fund balances	<u>378,228</u>	<u>-</u>	<u>378,228</u>
Total liabilities and fund balances	<u>\$ 459,769</u>	<u>\$ 1,299,556</u>	<u>\$ 1,759,325</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, 2019

	Operating Fund	Replacement Fund	Total
Revenues			
Member assessments	\$ 597,951	\$ 145,351	\$ 743,302
Investment income	3	24,666	24,669
Room rental	800	-	800
Recovery of bad debt	11,999	-	11,999
Other income	5,636	-	5,636
Total revenues	<u>616,389</u>	<u>170,017</u>	<u>786,406</u>
Expenses			
Landscape services	112,529	-	112,529
Pool/spa services	18,583	907	19,490
General maintenance and repairs	63,154	-	63,154
Pest control	5,598	-	5,598
Janitorial services	9,068	-	9,068
Water	59,499	-	59,499
Electricity	31,807	-	31,807
Gas	979	-	979
Refuse	71,532	-	71,532
Management fees	38,653	-	38,653
Office supplies/printing/postage	2,647	-	2,647
Insurance	126,382	-	126,382
Legal and collection	3,493	-	3,493
Audit/tax preparation	925	-	925
General and administrative	3,877	-	3,877
Furniture and equipment	-	203	203
Roofs	-	157,854	157,854
Wood repairs/replacement	-	6,450	6,450
Plumbing	-	4,603	4,603
Income taxes	8,405	-	8,405
Total expenses	<u>557,131</u>	<u>170,017</u>	<u>727,148</u>
Excess of revenues over expenses	59,258	-	59,258
Beginning fund balances	318,970	-	318,970
Ending fund balances	<u><u>\$ 378,228</u></u>	<u><u>\$ -</u></u>	<u><u>\$ 378,228</u></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, 2019

	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>Total</u>
Cash flows from operating activities:			
Excess of revenues over expenses	\$ 59,258	\$ -	\$ 59,258
Adjustments to reconcile excess of revenues over expenses to net cash provided by operating activities			
Increase in net assessments receivable	(13,845)	-	(13,845)
Increase in other receivables	-	(3,909)	(3,909)
Decrease in accrued interest receivable	-	533	533
Increase in prepaid insurance	(2,572)	-	(2,572)
Increase in accounts payable	32,972	7,471	40,443
Increase in prepaid/deferred assessments	9,627	186,698	196,325
Increase in other payables	2,905	-	2,905
Decrease in income taxes payable	(1,305)	-	(1,305)
Total adjustments	<u>27,782</u>	<u>190,793</u>	<u>218,575</u>
Net cash provided by operating activities	87,040	190,793	277,833
Cash flows from investing activities:			
Purchase of investments - net	-	(143,331)	(143,331)
Net cash used in investing activities	-	(143,331)	(143,331)
Cash flows from financing activities:			
Change in interfund payable balances	84,821	(84,821)	-
Net cash provided by (used in) financing activities	84,821	(84,821)	-
Net increase (decrease) in cash and cash equivalents	171,861	(37,359)	134,502
Cash and cash equivalents at beginning of year	316,414	231,294	547,708
Cash and cash equivalents at end of year	<u>\$ 488,275</u>	<u>\$ 193,935</u>	<u>\$ 682,210</u>
Supplemental disclosure			
Income taxes paid	<u>\$ 9,710</u>	<u>\$ -</u>	<u>\$ 9,710</u>

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

CYPRESS HOME OWNERS ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2019

NOTE 1 - NATURE OF ORGANIZATION

Cypress Home Owners Association ("Association") is a nonprofit mutual benefit corporation responsible for preserving and maintaining the common property within the development. The Association consists of 250 residential units occupying a site in Cypress, California and was incorporated on February 10, 1965.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of Accounting: Accounting records for the Association are maintained on a modified accrual basis of accounting, which recognizes assessments when billed, but recognizes other revenues when received and expenses when paid. For audit and tax purposes, adjustments have been made to convert the Association's financial statements to the full accrual basis of accounting, which recognizes revenues when earned and expenses when incurred.

(b) Fund Accounting: The Association uses fund accounting which requires that funds be classified separately for accounting and reporting purposes. Financial resources are classified in the following funds established according to their nature and purpose:

Operating Fund - Available for normal operating purposes. Disbursements are generally at the discretion of the Board of Directors.

Replacement Fund - Available for major repairs and replacements of common area components. Disbursements generally may be made only for their designated purpose.

(c) Capitalization and Depreciation Policy: Real property contributed by the developer as well as replacements and improvements are generally not capitalized since the Association's governing documents impose restrictions on its disposition. Significant personal property assets, if any, are generally capitalized at cost and depreciated over its estimated useful life using the straight-line method of depreciation.

(d) Cash Equivalents and Investments: Cash equivalents consist primarily of certificates of deposit and other securities with original maturities of 90 days or less. Investments consist primarily of certificates of deposit and other securities with original maturities over 90 days. Investments are considered to be held to maturity which range from January 2020 to July 2021. Cash equivalents and investments are stated at cost.

(e) Investment Income: Investment income consists primarily of interest and dividends earned on cash, cash equivalents and investment accounts, and is recorded as it is earned. Investment income is generally accounted for in the fund in which it is earned.

(f) Estimates: Financial statements prepared in conformity with generally accepted accounting principles require the use of estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

(g) Subsequent Events: The Association has evaluated subsequent events and transactions for potential recognition or disclosure in the financial statements through April 22, 2020, the date the financial statements were available to be issued.

CYPRESS HOME OWNERS ASSOCIATION
NOTES TO FINANCIAL STATEMENTS - CONTINUED
DECEMBER 31, 2019

NOTE 3 - FUTURE MAJOR REPAIRS AND REPLACEMENTS

The Association is in compliance with its governing documents that require funds be accumulated for future major repairs and replacements of common property components. Substantially all accumulated funds are held in separate accounts and are generally not available for normal operating purposes.

The Association's reserve funding policy was based on a study conducted as of December 2019, by an independent analyst to estimate the remaining useful lives and costs of future major repairs and replacements of common property components. The study recommends a fully funded reserve balance of \$1,882,464. As of December 31, 2019, the actual available replacement fund balance was \$1,205,102. The study recommends an annual member contribution of \$312,000. The Association's 2020 budget includes a reserve contribution of \$340,195.

Funds are being accumulated in the replacement fund based on estimated future costs. Actual expenditures may vary from the estimated amounts and the variations may be material. Therefore, amounts accumulated in the replacement fund may not be adequate to meet all future needs. If additional funds are needed, the Association has the right to increase assessments, pass special assessments, or delay repairs and replacements until funds are available.

NOTE 4 - INCOME TAXES

For the year ended December 31, 2019, the Association qualified as a tax-exempt homeowners' association under Internal Revenue Code Section 528 and California Revenue and Taxation Code Section 23701t. Under these Sections the Association is not taxed on net income related to its exempt purpose, which is the acquisition, construction, management, maintenance, and care of Association property. Net nonexempt function income, which includes investment income and revenues received from nonmembers, is taxed at 30% by the federal government and 8.84% by the State of California.

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.

NOTE 5 - MEMBER ASSESSMENTS

Association members are subject to paying assessments to fund the Association's operating activities and future major repairs and replacements. Assessment revenue is recognized as the related performance obligations are satisfied. The Association's performance obligations related to its operating assessments are 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 the funds are expended for their designated purpose. The annual budget and member assessments are determined by the Board of Directors. The Association retains excess funds at the end of the year, if any, for use in future periods.

CYPRESS HOME OWNERS ASSOCIATION
NOTES TO FINANCIAL STATEMENTS - CONTINUED
DECEMBER 31, 2019

NOTE 6 - ASSESSMENTS RECEIVABLE

Assessments receivable represent assessments and other fees due from members. The Association's governing documents provide for various collection remedies for delinquent assessments including the filing of liens, foreclosing on the unit owner, and obtaining judgment on other assets of the unit owner. 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. The balances of assessments receivable as of the beginning and end of the year are \$37,093 and \$37,938, respectively.

The Association records an allowance for doubtful accounts as 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 90 days.

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

NOTE 7 - PREPAID/DEFERRED ASSESSMENTS

The Association recognizes revenue from members as the related performance obligations are satisfied. Prepaid/deferred assessments are recorded when the Association receives payment in advance of the satisfaction of performance obligations. The total column balances of prepaid/deferred assessments as of the beginning and end of the year are \$17,431 and \$1,318,281, respectively.

NOTE 8 - 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 (CIRA), 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 new guidance as of January 01, 2019, 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 01, 2019. Adoption of the new guidance resulted in changes to the Association's accounting policies for assessment revenue and prepaid assessments, as previously described.

The adoption of the new revenue recognition guidance resulted in the following change to beginning fund balances (total column):

Beginning fund balances as previously reported	\$ 1,423,495
Adjustment	<u>(1,104,525)</u>
Beginning fund balances as adjusted	<u>\$ 318,970</u>

CYPRESS HOME OWNERS ASSOCIATION
NOTES TO FINANCIAL STATEMENTS - CONTINUED
DECEMBER 31, 2019

NOTE 8 - FASB ASC 606 NEW ACCOUNTING GUIDANCE IMPLEMENTATION (CONTINUED)

The effect of the adoption is a decrease in member assessments by \$186,698 and a recording of prepaid/deferred assessments of \$1,291,223. The Association has no customer contract modifications that had an effect on the Association's transition to the new guidance.

The modified retrospective method of transition requires the Association to disclose the effect of applying the new guidance on each item included in the financial statements. Following are the line items from the balance sheet as of December 31, 2019, and the statements of revenues, expenses, and changes in fund balances, and cash flows for the year then ended, that were affected:

	Amounts That Would Have Been Reported	Effects of Applying New Guidance	As Reported (Total Column)
Prepaid/deferred assessments	\$ 27,058	\$ 1,291,223	\$ 1,318,281
Ending fund balances	1,669,451	(1,291,223)	378,228
Member assessments	930,000	(186,698)	743,302
Excess of revenues over expenses	245,956	(186,698)	59,258
Change in prepaid/deferred assessments	9,627	186,698	196,325

NOTE 9 - CONCENTRATION OF CREDIT RISK

The Federal Deposit Insurance Corporation (FDIC) standard coverage amount is \$250,000 per depositor, per insured bank. As of December 31, 2019, the Association had deposits with Alliance Association Bank that exceeded the FDIC coverage limit by approximately \$124,000.

NOTE 10 - 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.

CYPRESS HOME OWNERS ASSOCIATION
SUPPLEMENTARY INFORMATION ON FUTURE MAJOR
REPAIRS AND REPLACEMENTS
AS OF DECEMBER 31, 2019
(UNAUDITED)

A study was conducted as of December 2019, by an independent analyst to estimate the remaining useful lives and the repair and replacement costs of common property components. The study was based on information provided by management, the Board of Directors, and Association vendors, as well as the knowledge and experience of the analyst. The study preparer may also use published manuals such as construction estimators, appraisal handbooks and valuation guides to estimate costs and remaining useful lives. The estimated costs were based on current estimated repair and replacement costs at the time of the study. Funding requirements consider an inflation rate of 3%, and an investment rate of 1.5% on accumulated replacement funds. The study recommends a fully funded reserve balance of \$1,882,464. As of December 31, 2019, the actual available replacement fund balance was \$1,205,102. The study recommends an annual member contribution of \$312,000. The Association's 2020 budget includes a reserve contribution of \$340,195.

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

Common Property Components	Estimated Remaining Useful Lives (Years)	Estimated Repair and Replacement Costs
Roofing	2 - 29	\$ 2,463,672
Painting	1 - 10	328,040
Asphalt/driveways	7	10,300
Fencing/rails	0 - 17	50,316
Clubhouse #1	0 - 16	48,513
Clubhouse #2	0 - 16	45,887
Pool area #1	0 - 4	37,544
Pool area #2	0 - 6	34,969
Pool area #3	0 - 16	29,201
Tot lot equipment	6 - 11	98,880
Landscaping	0 - 1	154,500
Lighting	3	10,300
Miscellaneous	10 - 16	263,474
Total		<u>\$ 3,575,596</u>