

# TREO MAINTENANCE ASSOCIATION

DATE: August 2020  
TO: Treo Maintenance Association  
FROM: Rina Sagal, Community Manager

Dear Homeowner:

In accordance with California Civil Code Section 5305 enclosed you will find a copy of the Annual Audit for the fiscal year end December 31, 2019. This audit was prepared by an independent CPA firm, Owens, Moskowitz and Associates, Inc. and has been accepted by the Board of Directors. You may view a copy of the complete audit at [www.myhoa.com/treo](http://www.myhoa.com/treo).

Please be advised, as a property owner, you have the right under California Civil Code Section 4950 to obtain copies of minutes of the Board of Directors meetings for a nominal fee. You may send your request in writing to the Board of Directors in care of Management at the address below.

The meetings of the Board of Directors are scheduled to be held on a regular basis on the third Tuesday of the odd months at the Woodbury Clubhouse. These meeting dates are subject to change or cancellation if there is a lack of quorum of the Board. Please call StoneKastle Community Management to confirm the meeting you plan to attend.

Should you have any questions, regarding the enclosed information, please contact the Board, in writing or attend a Board meeting.

Enclosures: Audit

**TREO MAINTENANCE ASSOCIATION**

Audited Financial Statements

For The Year Ended December 31, 2019

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# OWENS, MOSKOWITZ AND ASSOCIATES, INC.

CERTIFIED PUBLIC ACCOUNTANTS

27792 EL LAZO

LAGUNA NIGUEL, CALIFORNIA 92677

TELEPHONE: (949) 851-5020 • FAX (949) 851-9048

E-MAIL: raocpa@aol.com Web Site: www.raocpa.com

MEMBER:  
AMERICAN INSTITUTE  
OF CERTIFIED  
PUBLIC ACCOUNTANTS

MEMBER:  
CALIFORNIA SOCIETY  
OF CERTIFIED PUBLIC  
ACCOUNTANTS

## INDEPENDENT AUDITORS' REPORT

Board of Directors  
Treo Maintenance Association

We have audited the accompanying financial statements of Treo Maintenance 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 Treo Maintenance 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.*

July 23, 2020

TREO MAINTENANCE ASSOCIATION  
BALANCE SHEET  
DECEMBER 31, 2019

	OPERATING FUND	REPLACEMENT FUND	TOTAL
<b>ASSETS</b>			
Cash	\$ 11,186	\$ 643,943	\$ 655,129
Short-Term Investments	-	475,000	475,000
Assessments Receivable	9,267	-	9,267
Less: Allowance For Doubtful Accounts	(5,820)	-	(5,820)
Interest Receivable	-	1,855	1,855
Prepaid Insurance	6,408	-	6,408
<b>Total Assets</b>	<b>\$ 21,041</b>	<b>\$ 1,120,798</b>	<b>\$ 1,141,839</b>
<b>LIABILITIES AND ASSOCIATION FUNDS</b>			
Liabilities			
Accounts Payable	\$ 14,502	\$ -	\$ 14,502
Prepaid Assessments	8,212	-	8,212
Contract Liabilities (Assessments Received In Advance - Replacement Reserve)	-	1,120,798	1,120,798
Income Taxes Payable	1,213	-	1,213
<b>Total Liabilities</b>	<b>23,927</b>	<b>1,120,798</b>	<b>1,144,725</b>
Commitments	-	-	-
<b>Association Deficit</b>	<b>(2,886)</b>	-	<b>(2,886)</b>
<b>Total Liabilities And Association Funds</b>	<b>\$ 21,041</b>	<b>\$ 1,120,798</b>	<b>\$ 1,141,839</b>

SEE INDEPENDENT AUDITORS' REPORT AND ACCOMPANYING NOTES

TREO MAINTENANCE ASSOCIATION  
STATEMENT OF REVENUE EXPENSES AND ASSOCIATION FUNDS  
FOR THE YEAR ENDED DECEMBER 31, 2019

	OPERATING FUND	REPLACEMENT FUND	TOTAL
	<u>          </u>	<u>          </u>	<u>          </u>
<b>REVENUE</b>			
Assessments	\$ 183,504	\$ 6,322	\$ 189,826
Price Adjustment - Bad Debt	(5,820)	-	(5,820)
Interest Income	-	14,462	14,462
Other Income	5,718	-	5,718
<b>Total Revenue</b>	<b>183,402</b>	<b>20,784</b>	<b>204,186</b>
<b>EXPENSES</b>			
Landscape Maintenance	82,663	18,114	100,777
Management Fees	18,635	-	18,635
Administrative	12,232	-	12,232
Legal And Audit	2,311	-	2,311
Insurance	23,214	-	23,214
Pest Control	4,699	-	4,699
Painting	-	2,340	2,340
General Maintenance	26,438	330	26,768
Reserve Study	800	-	800
Electricity	6,196	-	6,196
Water	12,925	-	12,925
Lighting and Electrical	8,081	-	8,081
Plumbing	3,332	-	3,332
Income Tax	4,757	-	4,757
<b>Total Expenses</b>	<b>206,283</b>	<b>20,784</b>	<b>227,067</b>
Deficiency of Revenue Over Expenses	(22,881)	-	(22,881)
Association Funds Balance Beginning of Year	19,995	-	19,995
Association Deficit End of Year	<u>\$ (2,886)</u>	<u>\$ -</u>	<u>\$ (2,886)</u>

SEE INDEPENDENT AUDITORS' REPORT AND ACCOMPANYING NOTES

TREC MAINTENANCE ASSOCIATION  
STATEMENT OF CASH FLOWS  
FOR THE YEAR ENDED DECEMBER 31, 2019

	OPERATING FUND	REPLACEMENT FUND	TOTAL
	<u>          </u>	<u>          </u>	<u>          </u>
<b>Cash Flows From Operating Activities:</b>			
Cash Received From Members	\$ 187,367	\$ 140,496	\$ 327,863
Cash Paid To Suppliers of Goods And Services	(191,313)	(20,784)	(212,097)
Interest Received	-	19,833	19,833
Income Taxes Paid	(6,087)	-	(6,087)
<b>Net Cash Provided By (Used In) Operating Activities</b>	<b>(10,033)</b>	<b>139,545</b>	<b>129,512</b>
<b>Cash Flows From Investing Activities:</b>			
Maturity (Purchase) of Short-Term Investments	-	200,000	200,000
<b>Net Increase (Decrease) In Cash And Cash Equivalents</b>	<b>(10,033)</b>	<b>339,545</b>	<b>329,512</b>
<b>Cash And Cash Equivalents At Beginning of Year</b>	<b>21,219</b>	<b>304,398</b>	<b>325,617</b>
<b>Cash And Cash Equivalents At End of Year</b>	<b>\$ 11,186</b>	<b>\$ 643,943</b>	<b>\$ 655,129</b>

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

<b>Deficiency of Revenue Over Expenses</b>	<b>\$ (22,881)</b>	<b>\$ -</b>	<b>\$ (22,881)</b>
<b>Adjustments To Reconcile Deficiency of Revenue Over Expenses To Net Cash Provided By Operating Activities:</b>			
Change In Assessments Receivable	1,696	-	1,696
Change In Interest Receivable	-	5,371	5,371
Change In Prepaid Insurance	(133)	-	(133)
Change In Prepaid Expenses	500	-	500
Change In Accounts Payable	9,846	-	9,846
Change In Contract Liabilities	-	134,174	134,174
Change In Prepaid Assessments	2,269	-	2,269
Change In Income Tax Payable	(1,330)	-	(1,330)
<b>Net Cash Provided By (Used In) Operating Activities</b>	<b>\$ (10,033)</b>	<b>\$ 139,545</b>	<b>\$ 129,512</b>

SEE INDEPENDENT AUDITORS' REPORT AND ACCOMPANYING NOTES



TREO MAINTENANCE ASSOCIATION  
NOTES TO FINANCIAL STATEMENTS  
FOR THE YEAR ENDED DECEMBER 31, 2019

NOTE 1 NATURE OF ORGANIZATION

Treo Maintenance Association was incorporated on January 13, 2005, 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 Irvine, California. The development consists of 135 residential units.

NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Method of Accounting

The books of Treo Maintenance 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

TREO MAINTENANCE 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 monthly 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 \$5,820 where an 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 \$5,143 and \$9,267, 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:

Contract Liabilities, As Adjusted, at January 1, 2019	\$	986,624
Assessments Budgeted for Replacement Reserve		140,496
Revenue Released to Match Reserve Expenses		<u>(6,322)</u>
Contract Liabilities, at December 31, 2019	\$	<u>1,120,798</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

TREGO MAINTENANCE 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 \$ 1,186,491 at that date. The study recommends a 2020 contribution to the replacement fund of \$ 148,500 (\$ 91.67 per owner per month), which the 2020 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.

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 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.

SEE INDEPENDENT AUDITORS' REPORT

TREO MAINTENANCE ASSOCIATION  
NOTES TO FINANCIAL STATEMENTS  
FOR THE YEAR ENDED DECEMBER 31, 2019  
(CONTINUED)

NOTE 4 INCOME TAXES (Continued)

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:

2019 INCOME TAXES	FEDERAL	STATE TAX	STATE FEE	TOTAL
Income Taxes	\$ 3,526	\$ 1,221	\$ 10	\$ 4,757
Less: Estimated payments	(2,616)	(928)	-	(3,544)
<b>Income tax payable</b>	<b>\$ 910</b>	<b>\$ 293</b>	<b>\$ 10</b>	<b>\$ 1,213</b>

NOTE 5 ASSESSMENTS

During 2019, assessments were billed at a rate of \$ 200 per unit per month. Effective January 1, 2020, the rate increased to \$ 230 per unit per month.

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 \$134,174 and a recording of a contract liability (assessments received in advance-replacement fund) at December 31, 2019, of \$1,120,798. The Association has no customer contract modifications that had an effect on the Association's transition to the new guidance.

SEE INDEPENDENT AUDITORS' REPORT

TREC MAINTENANCE ASSOCIATION  
NOTES TO FINANCIAL STATEMENTS  
FOR THE YEAR ENDED DECEMBER 31, 2019  
(CONTINUED)

NOTE 7 CONTINGENCY

On March 11, 2020, the World Health Organization declared the novel strain of coronavirus (COVID-19) a global pandemic and recommended containment and mitigation measures worldwide. The outbreak in the United States has caused business disruption through mandated and voluntary closings of businesses and shelter in place orders. While the disruption is currently expected to be temporary, there is considerable uncertainty around the duration of the closings and shelter in place orders. It is at least reasonably possible that this matter will negatively impact the Association. However, the financial impact and duration cannot be reasonably estimated at this time.

NOTE 8 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 July 23, 2020, which is the date on which the financial statements were issued.

Subsequent to year end, the Association entered into a contract for roof maintenance and gutter cleaning for a total of \$15,985.

SEE INDEPENDENT AUDITORS' REPORT

SUPPLEMENTAL INFORMATION

TREO MAINTENANCE ASSOCIATION  
 SUPPLEMENTAL INFORMATION ON FUTURE MAJOR REPAIRS  
 AND REPLACEMENTS  
 DECEMBER 31, 2019  
 (UNAUDITED)

The board of directors contracted an independent consultant who conducted a October 30, 2019 study, projected to December 31, 2019, 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 2.0%.

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>
Streets	1 to 13 years	\$ 110,327	\$ 6,729	\$ 58,855
Roofs - Tile Repairs	0 years	15,443	13,885	15,443
Painting	0 to 4 years	239,190	40,303	170,629
Gates/Railing/Walls	4 to 19 years	304,578	15,649	193,100
Lighting	11 to 13 years	133,805	5,486	70,469
Decks/Doors	0 to 16 years	581,036	33,964	369,450
Building Exterior	5 to 21 years	289,259	16,281	130,805
Grounds	8 to 14 years	43,584	2,450	17,182
Termite Control	4 years	162,000	9,428	126,000
Contingency	n/a	-	4,325	34,558
		<u>\$ 1,879,222</u>	<u>\$ 148,500</u>	<u>\$ 1,186,491</u>

As shown above, the study recommends a cash replacement balance of \$1,186,491 as of December 31, 2019 and contributions to reserves of \$148,500 during 2020. The Association's total replacement fund total assets at December 31, 2019 were \$1,120,798 or 94.46% of the recommended balance.