

TREO MAINTENANCE ASSOCIATION

DATE: August 2021
TO: Treo Maintenance Association
FROM: Rina Sagal, Community Manager

Dear Homeowner:

In accordance with California Civil Code Section 5305 this notice is to advise you that the Annual Audit for the fiscal year end December 31, 2020 has been completed. 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.

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.

TREO MAINTENANCE ASSOCIATION

Audited Financial Statements

For The Year Ended December 31, 2020

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OWENS, MOSKOWITZ AND ASSOCIATES, INC.

CERTIFIED PUBLIC ACCOUNTANTS

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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, 2020, 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, 2020, 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 13 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.

June 22, 2021

Owens, Moskowitz and Associates, Inc.

TREC MAINTENANCE ASSOCIATION
BALANCE SHEET
DECEMBER 31, 2020

	OPERATING FUND	REPLACEMENT FUND	TOTAL
ASSETS			
Cash	\$ 49,954	\$ 535,304	\$ 585,258
Short-Term Investments	-	650,000	650,000
Assessments Receivable	13,538	-	13,538
Less: Allowance For Doubtful Accounts	(8,887)	-	(8,887)
Interest Receivable	-	392	392
Prepaid Taxes	3,437	-	3,437
Prepaid Insurance	6,520	-	6,520
Due From/(Due To) Other Funds	(25,000)	25,000	-
Total Assets	\$ 39,562	\$ 1,210,696	\$ 1,250,258
LIABILITIES AND ASSOCIATION FUNDS			
Liabilities			
Accounts Payable	\$ 3,028	\$ -	\$ 3,028
Prepaid Assessments	15,768	-	15,768
Deferred Revenue (Assessments Received In Advance - Replacement Fund)	-	1,210,696	1,210,696
Total Liabilities	18,796	1,210,696	1,229,492
Commitments	-	-	-
Association Funds	20,766	-	20,766
Total Liabilities And Association Funds	\$ 39,562	\$ 1,210,696	\$ 1,250,258

SEE INDEPENDENT AUDITORS' REPORT AND ACCOMPANYING NOTES

TREC MAINTENANCE ASSOCIATION
STATEMENT OF REVENUE EXPENSES AND ASSOCIATION FUNDS
FOR THE YEAR ENDED DECEMBER 31, 2020

	OPERATING FUND	REPLACEMENT FUND	TOTAL
REVENUE			
Assessments	\$ 224,100	\$ 58,602	\$ 282,702
Price Adjustment - Bad Debt	(3,067)	-	(3,067)
Interest Income	-	5,979	5,979
Other Income	9,930	2,315	12,245
Total Revenue	230,963	66,896	297,859
EXPENSES			
Landscape Maintenance	92,451	-	92,451
Management Fees	18,635	-	18,635
Administrative	8,973	-	8,973
Legal And Audit	6,898	-	6,898
Insurance	26,332	-	26,332
Pest Control	2,892	-	2,892
Painting	-	575	575
General Maintenance	14,544	9,119	23,663
Reserve Study	450	-	450
Electricity	6,388	-	6,388
Water	9,316	-	9,316
Doors	-	2,589	2,589
Fire System	-	32,335	32,335
Lighting and Electrical	8,417	2,742	11,159
Plumbing	10,700	-	10,700
Roof and Decks	-	19,536	19,536
Income Tax	1,315	-	1,315
Total Expenses	207,311	66,896	274,207
Excess of Revenue Over Expenses	23,652	-	23,652
Association Funds Balance (Deficit) Beginning of Year	(2,886)	-	(2,886)
Association Funds Balance End of Year	\$ 20,766	\$ -	\$ 20,766

SEE INDEPENDENT AUDITORS' REPORT AND ACCOMPANYING NOTES

TREC MAINTENANCE ASSOCIATION
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2020

	OPERATING FUND	REPLACEMENT FUND	TOTAL
Cash Flows From Operating Activities:			
Cash Received From Members	\$ 237,315	\$ 150,815	\$ 388,130
Cash Paid To Suppliers of Goods And Services	(217,582)	(66,896)	(284,478)
Interest Received	-	7,442	7,442
Income Taxes Paid	(5,965)	-	(5,965)
Net Cash Provided By Operating Activities	13,768	91,361	105,129
Cash Flows From Investing Activities:			
Purchase of Short-Term Investments	-	(175,000)	(175,000)
Cash Flows From Financing Activities:			
Interfund Borrowings	25,000	(25,000)	-
Net Increase (Decrease) In Cash And Cash Equivalents	38,768	(108,639)	(69,871)
Cash And Cash Equivalents At Beginning of Year	11,186	643,943	655,129
Cash And Cash Equivalents At End of Year	<u>\$ 49,954</u>	<u>\$ 535,304</u>	<u>\$ 585,258</u>

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

Excess of Revenue Over Expenses	\$ 23,652	\$ -	\$ 23,652
Adjustments To Reconcile Excess of Revenue Over Expenses To Net Cash Provided By Operating Activities:			
Change In Assessments Receivable	(1,204)	-	(1,204)
Change In Interest Receivable	-	1,463	1,463
Change In Prepaid Insurance	(112)	-	(112)
Change In Prepaid Taxes	(3,437)	-	(3,437)
Change In Accounts Payable	(11,474)	-	(11,474)
Change In Deferred Revenue	-	89,898	89,898
Change In Prepaid Assessments	7,556	-	7,556
Change In Income Tax Payable	(1,213)	-	(1,213)
Net Cash Provided By Operating Activities	<u>\$ 13,768</u>	<u>\$ 91,361</u>	<u>\$ 105,129</u>

SEE INDEPENDENT AUDITORS' REPORT AND ACCOMPANYING NOTES

TREC MAINTENANCE ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2020

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.

Deferred Revenue (Assessments received in advance-replacement fund)

The Association recognizes revenue from members as the related performance obligations are satisfied. Deferred revenue (assessments received in advance-replacement fund) is 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 deferred revenue (assessments received in advance-replacement fund) during 2020 is as follows:

Deferred Revenue, at January 1, 2020	\$ 1,120,798
Assessments Budgeted for Replacement Reserve	148,500
Revenue Released to Match Reserve Expenses	<u>(58,602)</u>
Deferred Revenue, at December 31, 2020	<u>\$ 1,210,696</u>

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.

TREC MAINTENANCE ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2020
(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, 2020, the Association had delinquent assessments of \$8,887, 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 \$9,267 and \$13,338, respectively.

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.

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.

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

TREC MAINTENANCE ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 2020
(CONTINUED)

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, 2020, indicates the Association's ideal cash replacement fund balance was \$ 1,115,071 at that date. The study recommends a 2021 contribution to the replacement fund of \$ 150,500 (\$ 92.90 per owner per month), which the 2021 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 2020, the Association filed as a regular corporation for federal taxes, since it had an excess of maintenance expenses over membership source income carried from prior years. 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.

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, 2020, 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 2016.

SEE INDEPENDENT AUDITORS' REPORT

TREC MAINTENANCE ASSOCIATION
 NOTES TO FINANCIAL STATEMENTS
 FOR THE YEAR ENDED DECEMBER 31, 2020
 (CONTINUED)

NOTE 4 INCOME TAXES (Continued)

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:

2020 INCOME TAXES	FEDERAL	STATE TAX	STATE FEE	TOTAL
Income Taxes	\$ 848	\$ 467	\$ -	\$ 1,315
Less: Estimated payments	(3,528)	(1,224)	-	(4,752)
Prepaid tax	<u>\$ 2,680</u>	<u>\$ 757</u>	<u>\$ -</u>	<u>\$ 3,437</u>

NOTE 5 ASSESSMENTS

During 2020, assessments were billed at a rate of \$ 230 per unit per month. The rate is budgeted to remain at \$ 230 per unit per month for 2021.

NOTE 6 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 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, 2020, the date of the most recent balance sheet, have been evaluated for possible adjustment to the financial statements or disclosure is June 22, 2021, which is the date on which the financial statements were issued.

SEE INDEPENDENT AUDITORS' REPORT

SUPPLEMENTAL INFORMATION

TREC MAINTENANCE ASSOCIATION
 SUPPLEMENTAL INFORMATION ON FUTURE MAJOR REPAIRS
 AND REPLACEMENTS
 DECEMBER 31, 2020
 (UNAUDITED)

The board of directors contracted an independent consultant who conducted a June 10, 2020 study, projected to December 31, 2020, to estimate the remaining useful lives and replacement costs of the components of common property. Funding requirements include an inflation factor of 3% and an interest rate of 1.75%.

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>2021 Funding Requirement</u>	<u>Recommended Fund Balances</u>
Streets	0 to 12 years	\$ 113,914	\$ 7,136	\$ 67,493
Roofs - Tile Repairs	0 years	15,842	14,514	15,842
Painting	0 to 4 years	243,812	40,316	83,642
Gates/Railing/Walls	4 to 18 years	313,466	16,079	204,681
Lighting	10 to 12 years	135,790	5,863	76,624
Decks/Doors	4 to 15 years	583,241	34,839	343,482
Building Exterior	4 to 20 years	279,927	14,730	133,810
Grounds	8 to 13 years	44,500	2,556	19,207
Termite Control	3 years	165,375	10,085	137,813
Contingency	n/a	-	4,383	32,478
		<u>\$ 1,895,868</u>	<u>\$ 150,500</u>	<u>\$ 1,115,071</u>

As shown above, the study recommends a cash replacement balance of \$1,115,071 as of December 31, 2020 and contributions to reserves of \$150,500 during 2021. The Association's total replacement fund total assets at December 31, 2020 were \$1,185,304 or 106.3% of the recommended balance.