

# **HERITAGE RANCH OWNERS ASSOCIATION**

**Auditors' Report,  
Financial Statements  
and  
Supplemental Information  
June 30, 2011**

**SBH & ASSOCIATES, LLP**  
*Certified Public Accountants*



SBH & Associates, LLP

Board of Directors and Members  
Heritage Ranch Owners Association  
Paso Robles, CA

### **Independent Auditors' Report**

We have audited the accompanying balance sheet of Heritage Ranch Owners Association as of June 30, 2011 and the related statements of revenues and 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.

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 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.

In our opinion, the financial statements referred to in the first paragraph above present fairly, in all material respects, the financial position of Heritage Ranch Owners Association as of June 30, 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 of America.

Accounting principles generally accepted in the United States of America require that Supplemental Information on Replacement Fund Balances is 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.

*SBH and Associates, LLP*

Palm Springs, CA  
August 29, 2011

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# Heritage Ranch Owners Association

## Balance Sheet

As of June 30, 2011

With comparative data as of June 30, 2010

	2011			2010
	Operating Fund	Replacement Fund	Total Funds	Total Funds
<b><u>ASSETS</u></b>				
Cash	\$ 132,693	\$ 339,786	\$ 472,479	\$ 897,564
Investments	-	1,005,000	1,005,000	705,000
Assessments receivable, net of allowance for doubtful accounts of \$120,047	111,027	-	111,027	111,824
Other receivables	-	-	-	875
Accrued interest	-	-	-	8,029
Prepaid expenses	9,158	-	9,158	41,296
Prepaid income taxes	-	-	-	35
Property and equipment, net of accumulated depreciation of \$861,310	382,331	-	382,331	261,987
Due to/from other fund	(154,033)	154,033	-	-
Restricted assets, for member deposits				
Cash	63,100	-	63,100	98,600
Investments	130,000	-	130,000	100,000
Total assets	<u>\$ 674,276</u>	<u>\$ 1,498,819</u>	<u>\$ 2,173,095</u>	<u>\$ 2,225,210</u>
<b><u>LIABILITIES</u></b>				
Accounts payable	\$ 16,612	\$ -	\$ 16,612	\$ 43,852
Accrued payroll and related expenses	43,520	-	43,520	56,601
Prepaid assessments	128,948	-	128,948	148,116
Lease payable	-	-	-	-
Income taxes payable	-	-	-	681
Deferred income - boat slips	60,000	-	60,000	60,000
Architectural and other member deposits	193,100	-	193,100	198,600
Total liabilities	<u>442,180</u>	<u>-</u>	<u>442,180</u>	<u>507,850</u>
<b><u>FUND BALANCES</u></b>				
Fund balance - unappropriated	<u>232,096</u>	<u>1,498,819</u>	<u>1,730,915</u>	<u>1,717,360</u>
Total liabilities and fund balances	<u>\$ 674,276</u>	<u>\$ 1,498,819</u>	<u>\$ 2,173,095</u>	<u>\$ 2,225,210</u>

See Auditors' Report

The accompanying notes are an integral part of the financial statements.

**Heritage Ranch Owners Association**  
**Statement of Revenues and Expenses and Changes in Fund Balances**  
For the year ended June 30, 2011  
With comparative balances for the year ended June 30, 2010

	<b>2011</b>			<b>2010</b>
	<b>Operating Fund</b>	<b>Replacement Fund</b>	<b>Total Funds</b>	<b>Total Funds</b>
<b><u>REVENUES</u></b>				
Assessments	\$ 1,562,088	\$ 488,934	\$ 2,051,022	\$ 1,776,558
Interest income	4,443	10,860	15,303	30,960
Campground and marina	43,940	-	43,940	38,525
Recreational vehicle trash fees	28,944	-	28,944	28,944
Association fees	23,080	-	23,080	19,415
Traffic fines	50,875	-	50,875	47,115
Equestrian center	44,995	-	44,995	39,515
Late charges	22,408	-	22,408	20,187
Rental income	25,604	-	25,604	40,000
Other income	43,152	3,274	46,426	51,287
Total revenues	<u>1,849,529</u>	<u>503,068</u>	<u>2,352,597</u>	<u>2,092,506</u>
<b><u>EXPENSES</u></b>				
Administrative expenses	532,142	-	532,142	702,920
Code enforcement	593,582	-	593,582	583,904
Repair and maintenance	368,988	-	368,988	399,835
Campground and marina	21,701	-	21,701	23,054
Equestrian center	42,847	-	42,847	37,883
Recreation center	89,543	-	89,543	78,991
Recreational vehicle area	30,519	-	30,519	28,371
Income tax expenses	-	-	-	5,146
Bad debt expense	69,071	-	69,071	25,913
Activity expenses	31,423	-	31,423	-
Major repairs & replacements	-	522,094	522,094	116,593
Total expenses	<u>1,779,816</u>	<u>522,094</u>	<u>2,301,910</u>	<u>2,002,610</u>
Excess (deficiency) of revenues over expenses before depreciation	69,713	(19,026)	50,687	89,896
Depreciation	37,132	-	37,132	59,487
Excess (deficiency) of revenues over expenses	<u>32,581</u>	<u>(19,026)</u>	<u>13,555</u>	<u>30,409</u>
Fund balance, beginning of year	157,381	1,559,979	1,717,360	1,686,951
Fund transfers	42,134	(42,134)	-	-
Fund balance, end of year	<u>\$ 232,096</u>	<u>\$ 1,498,819</u>	<u>\$ 1,730,915</u>	<u>\$ 1,717,360</u>

# Heritage Ranch Owners Association

## Statement of Cash Flows

For the year ended June 30, 2011

With comparative balances for the year ended June 30, 2010

	2011		2010	
	Operating Fund	Replacement Fund	Total Funds	Total Funds
<b><u>Cash Flows From Operating Activities:</u></b>				
Excess (deficiency) of revenues over expenses	\$ 32,581	\$ (19,026)	\$ 13,555	\$ 30,409
<b><u>Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:</u></b>				
Depreciation	37,132	-	37,132	48,896
<b><u>Change in Assets and Liabilities:</u></b>				
Change in assessments receivable	797	-	797	(8,401)
Change in other receivables	875	-	875	252
Change in accrued interest	-	8,029	8,029	(8,029)
Change in prepaid expenses	32,138	-	32,138	2,113
Change in prepaid income tax	35	-	35	15,991
Change in restricted assets	5,500	-	5,500	5,700
Change in accounts payable	(27,240)	-	(27,240)	34,764
Change in accrued payroll and related expenses	(13,081)	-	(13,081)	3,447
Change in architectural and other member deposits	(5,500)	-	(5,500)	(5,700)
Change in income taxes payable	(681)	-	(681)	681
Change in deferred income - boat slips	-	-	-	40,000
Change in prepaid assessments	(19,168)	-	(19,168)	(25,260)
Total adjustments	10,807	8,029	18,836	104,454
Net cash provided (used) by operations	43,388	(10,997)	32,391	134,863
<b><u>Cash Flows from Investing Activities:</u></b>				
Net investments redeemed (purchased)	-	(300,000)	(300,000)	-
Property and equipment purchased	(157,476)	-	(157,476)	10,592
Net cash (used by) investing activities	(157,476)	(300,000)	(457,476)	10,592
<b><u>Cash Flows from Financing Activities:</u></b>				
Capital lease payments	-	-	-	(48,995)
Net borrowing between funds	109,345	(109,345)	-	-
Transfers between funds - equipment capitalized	42,134	(42,134)	-	-
Net cash provided (used) by financing activities	151,479	(151,479)	-	(48,995)
Net increase (decrease) in cash	37,391	(462,476)	(425,085)	96,460
Cash, beginning of year	95,302	802,262	897,564	801,104
Cash, end of year	\$ 132,693	\$ 339,786	\$ 472,479	\$ 897,564
<b><u>Supplemental information:</u></b>				
Cash paid for income taxes	\$ -	\$ -	\$ -	\$ 19,600
Cash paid for interest	\$ 245	\$ -	\$ 245	\$ -

See Auditors' Report

The accompanying notes are an integral part of the financial statements.

# Heritage Ranch Owners Association

## *Notes to Financial Statements*

For the Year Ended June 30, 2011

***NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES:***

**Organizational Data**

Heritage Ranch Owners Association was incorporated January 28, 1972. The Association is responsible for the maintenance and operation of the common areas of a 2,104 lot planned development located in San Luis Obispo County, California.

**Accounting Method**

The Association maintains its books of account on the accrual basis of accounting. Under this method of accounting, revenue is recognized when assessments are earned, or billed, and expenses are recognized when goods or services are received, whether paid or not.

**Fund Accounting**

The Association has segregated its activities into two funds; the operating fund, and the replacement fund. The operating fund accounts for all current operating transactions of the Association. The replacement fund accounts for member capital contributions, which are accumulated in separate bank accounts to provide for the future repair and replacement of the Association's common areas.

**Cash and Cash Equivalents**

For purposes of the statement of cash flows, cash and cash equivalents include cash on hand, funds on deposit with financial institutions, investments with an original maturity of three months or less.

**Investments**

Investments are accounted for at cost which approximate fair value and consist of Certificates of Deposits based on readily available market values. The carrying amount of these investments held at June 30, 2011, was \$1,005,000. Member deposits invested in Certificates was \$130,000. These investments are FDIC insured.

<b><u>Reserve assessments</u></b>	<b><u>Amount</u></b>
First American Bank	\$90,000
Central Bank	195,000
First Bank	50,000
Aurora Bank	150,000
GE Capital Bank	150,000
Safra National Bank	120,000
Integra Bank	75,000
Integra Bank	75,000
Doral Bank	100,000
	<u>\$1,005,000</u>
<b><u>Member deposits</u></b>	
Integra Bank	\$100,000
Bank of China	30,000
	<u>\$130,000</u>

**Assessments Receivable**

Assessments receivable, as reflected in the financial statements, are from members whose lots are located within the Heritage Ranch development. An allowance for bad debts is included in the financial statements. The Association has the right to levy liens on a member's property to ensure payment of an assessment due the Association.

**Property, Equipment and Depreciation**

Real property common areas acquired by the Association from the developer and major repairs or replacements thereto are not capitalized on the Association financial statements. Although the Association has title to such assets, the assets are not severable or saleable by the board without member approval, nor do they produce significant income. Personal property purchased with Association funds, to which the Association holds title, is capitalized at cost and depreciated over the estimated useful lives of the assets purchased, using the straight-line method of depreciation over 3 to 30 years. Association common areas are restricted to use by Association members, their tenants, and guests. The Association is responsible for the preservation and maintenance of the common areas.

Property and equipment recorded in the financial statements consist of the following:

<b><u>Description</u></b>	<b><u>Amount</u></b>
Land	\$109,736
Buildings and Improvements	60,518
Equipment	414,054
Boat Slips	290,411
Office Equipment	71,781
Vehicles	197,551
Total Cost of Property	1,144,051
Accumulated Depreciation	(861,310)
Net Property & Equipment	\$ 382,331

Common area assets not recorded in the financial statements include fences, approximately 26 miles of streets, boat launch ramps, campgrounds, and various buildings including the recreation barn, maintenance buildings, and the fish station, and approximately 30 acres of parks, playgrounds, and sports fields.

# Heritage Ranch Owners Association

## Notes to Financial Statements

For the Year Ended June 30, 2011

### **NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES**

*(continued):*

#### **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 reporting period.

Estimates included in the preparation of these financial statements include bad debts, depreciation, and estimates of replacement fund components relating to useful life, replacement cost, inflation rates, and tax rates. Actual results could differ from those estimates.

#### **Lines of Business**

The Association conducts only one line of business, which is providing management and recreational services to its members. This consists primarily of maintenance of the common areas and related administrative functions.

#### **Deposits**

The Association holds various refundable deposits for construction or rentals. These amounts are held until construction is satisfactorily completed with no damage to Association common areas, or until the rental obligations are completed.

### **NOTE 2 - REPLACEMENT FUND AND RESTRICTED CASH:**

The Heritage Ranch Owners Association bylaws require a reserve study be prepared every three years. Common industry practices suggest that funds should be accumulated for the replacement of its common areas and for general operations. Such funds are intended to provide for the cost of future replacement, repairs and maintenance when it is estimated that such items are needed.

It is the Association's policy to fund its reserves on a monthly basis. The Association annually reviews its reserve funding program. The last review was last performed as part of the budget process for the current year. California Civil Code Section 1365 et.seq. mandates certain requirements for disclosure of the reserve funding program by the Association to its members. The Association believes that it has complied in all material respects with these requirements.

Actual expenditures may vary from estimated amounts and variations

may be material. Therefore, amounts accumulated in the replacement fund may not be adequate to meet future needs. The Association updates cost data annually.

Cash balances in amounts equal to the designated capital reserves represent cash restricted for this purpose only.

### **NOTE 3 - INCOME TAXES:**

The Association qualifies as a tax exempt Homeowners Association for all income and expenses related to its exempt function purpose of the acquisition, construction, management, maintenance and care of Association property. The net non-exempt income from earned interest is taxed at 30% by the Federal Government, based upon the election to file Form 1120-H.

Alternatively, the Association may be classified as a non-exempt membership organization for both federal and state income tax purposes. In general, the Association is required to classify its taxable income and deductions between member activities, non-member activities, and capital transactions (for capital replacement fund components). The Association is subject to specific rulings and regulations applicable to non-exempt membership organizations.

For federal tax purposes, the Association is taxed on all net income from non-member activities reduced only by losses from non-member activities for which a profit motive exists. Non-member income may not be offset by member losses, and any net member losses may only be carried forward to offset member income of future tax periods. Any net member income not applied to the subsequent tax year is subject to taxation. If this filing option is elected, the Association files Form 1120, with tax rates applicable to Association net taxable income are based on a graduated rate table with rates of 15% to 39%.

For California State income tax purposes, the Association is taxed on all net income from non-member activities reduced only by losses from non-member activities for which a profit motive exists. Non-member income may not be offset by member losses. Any net member income is not subject to taxation. The tax rate for Association net taxable income is 8.84%.

# **Heritage Ranch Owners Association**

## ***Notes to Financial Statements***

For the Year Ended June 30, 2011

### ***NOTE 4 - SIGNIFICANT GROUP CONCENTRATIONS OF CREDIT RISK:***

The Association maintains several bank accounts at various financial institutions. The balances in these accounts may occasionally exceed the federally insured (FDIC) amount of \$250,000. Brokerage accounts are not insured by FDIC, but are privately insured by the SIPC.

### ***NOTE 5 – BUDGETARY PROCESS***

The goal of the Association's budget policy, and State Civil Code is that the Association is not to generate any profits nor any losses. From a practical standpoint, it is impossible to have results of operations every year, resulting in neither profits, nor losses, because the organization must accumulate working capital funds to operate from year to year. Therefore, the Association will have either a profit, or a loss, each and every year. Excess operating profits may be retained in the Operating Fund, or transferred to the Major Repair and Replacement Fund, at the Board's discretion.

### ***NOTE 6 – DEPOSIT WITH COUNTY OF SAN LUIS OBISPO***

The Association has a performance agreement (removal bond) with the County of San Luis Obispo. Under this agreement the Association has two deposits with the County of San Luis Obispo in the form two CD's held at Rabobank with an interest rate of 0.85% as of June 30, 2011. The total amount of the two deposits is

\$33,125. These deposits are to guarantee that the guard houses shall be removed from the site or converted to such other use which may be approved by the Planning Commission at the time Gateway Drive and Heritage Loop Road is accepted by the Board of Supervisors into the county-maintained public road system or upon violation and nullification of the Conditional Use Permit for the guard houses. Under this agreement the Association cannot authorize release of the funds. The interest on the CDs is payable to HROA annually when the CDs are automatically renewed. The CDs will mature and automatically renew on December 05, 2011.

### ***NOTE 7 – CONTINGENCIES***

Certain claims arising in the ordinary course of business have been filed against the Association. In the opinion of management and Association counsel, all such matters are adequately covered by insurance, or if not so covered, are without merit or are of such kind, or involve such amounts, that would not have a significant effect on the financial position or results of operations of the Association if disposed of unfavorably. Therefore, no provision for loss has been included in the accompanying financial statements.

**Heritage Ranch Owners Association**  
**Supplemental Information on Replacement Fund Balances**  
For the Year Ended June 30, 2011  
(unaudited)

The board commissioned a study in 2007, which was updated in 2008, to estimate the remaining useful lives and the replacement costs of the components of common property. The Association has assessed the present condition of all common area components; estimated replacement costs relying upon published data, contractor's or engineer's estimates, and previously paid amounts; and estimated remaining lives, relying upon consultants or published data. Funding has been provided using a pooled calculation with provisions for inflation of 3%, interest earnings of 3.5%, and income tax rate of 20%. The Association has commissioned a new study for 2011-2012.

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

<b>Major Component</b>	<b>Remaining Life</b>	<b>Current Replacement Cost</b>	<b>Ending Fund Balance Allocation*</b>	<b>2011 Income Allocation</b>
Contingency	0-20	\$ 35,000	\$ -	\$ -
Doors	12-25	11,450	-	-
Equipment	1-30	653,893	-	-
Fencing	13-30	62,100	-	-
Fixtures	9-15	1,750	-	-
Furniture-Exterior	7-15	22,750	-	-
Furniture-Interior	10-25	19,100	-	-
Gates	6-21	57,000	-	-
Grounds	17-30	20,520	-	-
Lights	4-15	16,625	-	-
Painting	0-7	10,000	-	-
Plumbing & fixtures	15-30	16,095	-	-
Pools	3-15	81,800	-	-
Roads - 1"overlay	20-30	85,023	-	-
Roads - 1-1/2"overlay	0-30	1,092,414	-	-
Roads - 2"overlay	0-30	1,642,516	-	-
Roads - 2-1/2"overlay	9-15	915,446	-	-
Roads - Slurry	0-20	511,568	-	-
Roads - Stripe	5-7	24,653	-	-
Roofs	7-31	20,650	-	-
Signs	9-20	2,900	-	-
Software	2-5	2,125	-	-
Structures	7-35	516,050	-	-
Tennis Court	1-5	56,250	-	-
Wall Floor Covering	0-20	102,100	-	-
<b>Totals</b>		<b>\$ 5,979,778</b>	<b>\$ 1,559,979</b>	<b>\$ 465,000</b>

\*Allocation of audited fund balance not provided in the study