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January 30, 2017

Nellie Gail Ranch Owners Association Property Owners

**RE: ANNUAL AUDIT FOR FISCAL YEAR ENDING SEPTEMBER 30, 2016
NEWMAN & ASSOCIATES, INC. - CERTIFIED PUBLIC ACCOUNTANTS**

Dear Association Member:

In accordance with the requirements contained in the California Civil Code, attached please find the independent audit for the fiscal year ending September 30, 2016 for the Nellie Gail Ranch Owner's Association. This independent report verified the continuing financial strength and stability of your Association. The Board of Directors is very pleased to report that the Association continues to operate on a strong financial basis.

The audit entailed an analysis and examination of the Association's financial records, current accounting staff, internal controls, accounting systems, and supporting schedules, in accordance with auditing standards generally accepted in the United States of America, all of which confirmed the positive nature of the accounting environment at Nellie Gail Ranch Owners Association.

If you have any questions relating to the audit, the Association's budget, or the Association in general, please do not hesitate to contact Brian Mitchell, General Manager at bmitchell@nelliegailranch.org or by phone at 949-425-1477.

**NELLIE GAIL RANCH OWNERS' ASSOCIATION
FINANCIAL STATEMENTS
FOR THE YEAR ENDED SEPTEMBER 30, 2016**



**NELLIE GAIL RANCH OWNERS' ASSOCIATION
FINANCIAL STATEMENTS
For the Year Ended September 30, 2016**

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Independent Auditor's Report

To the Board of Directors of Nellie Gail Ranch Owners' Association

We have audited the accompanying financial statements of Nellie Gail Ranch Owners' Association (the "Association"), which comprise the balance sheet as of September 30, 2016, and the related statements of revenues, expenses, and changes in fund balance 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 Nellie Gail Ranch Owners' Association as of September 30, 2016, and 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.

Emphasis of a Matter – Future Major Repairs and Replacements

Our audit was made for the purpose of forming an opinion on the basis financial statements, taken as a whole. We have not applied procedures to determine whether the funds designated for future repairs and replacements (Note 4), are adequate to meet such future costs, because such determination is outside the scope of our audit. Our opinion is not modified with respect to this matter.

Disclaimer of Opinion of Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Supplementary Information on Future Repairs and Replacements on page 8 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, 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 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.

Newman & Associates, Inc

Newman and Associates, Inc.
An Accountancy Corporation
Carlsbad, California
November 18, 2016

NELLIE GAIL RANCH OWNERS' ASSOCIATION
BALANCE SHEET
September 30, 2016

	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>Equestrian Fund</u>	<u>Swim Fund</u>	<u>Tennis Fund</u>	<u>Total</u>
Assets						
Cash and cash equivalents	\$ 927,794	\$ 1,877,107	\$ 316,436	\$ 106,330	\$ 317,223	\$ 3,544,890
Investments		1,525,000				1,525,000
Assessments receivable	120,534		19,934			140,468
Allowance for doubtful accounts	(119,709)					(119,709)
Other receivable			2,500			2,500
Interest receivable		1,569				1,569
Prepaid insurance	48,746					48,746
Fixed assets	480,768		742,552	563,578	844,247	2,631,145
Accumulated depreciation	(345,176)		(599,697)	(472,029)	(666,968)	(2,083,870)
Deferred expenses	97,483					97,483
Total Assets	<u>\$ 1,210,440</u>	<u>\$ 3,403,676</u>	<u>\$ 481,725</u>	<u>\$ 197,879</u>	<u>\$ 494,502</u>	<u>\$ 5,788,222</u>
Liabilities						
Accounts payable	\$ 37,700	\$ -	\$ 22,487	\$ -	\$ -	\$ 60,187
Payroll payable	9,782		5,437			15,219
Prepaid assessments	193,218		3,690			196,908
Paid time off payable	16,268		11,609			27,877
Income taxes payable	2,595					2,595
Deposits	361,799		55,148			416,947
Total liabilities	<u>621,362</u>	<u>-</u>	<u>98,371</u>	<u>-</u>	<u>-</u>	<u>719,733</u>
Fund balances	<u>589,078</u>	<u>3,403,676</u>	<u>383,354</u>	<u>197,879</u>	<u>494,502</u>	<u>5,068,489</u>
Total liabilities and fund balances	<u>\$ 1,210,440</u>	<u>\$ 3,403,676</u>	<u>\$ 481,725</u>	<u>\$ 197,879</u>	<u>\$ 494,502</u>	<u>\$ 5,788,222</u>

The accompanying notes are an integral part of the financial statements
(See Independent Auditor's Report)

**NELLIE GAIL RANCH OWNERS' ASSOCIATION
STATEMENT OF REVENUES AND EXPENSES AND
CHANGES IN FUND BALANCES
For the Year Ended September 30, 2016**

	Operating Fund	Replacement Fund	Equestrian Fund	Swim Fund	Tennis Fund	Total
Revenues						
Owners' assessments	\$ 1,620,057	\$ 177,000	\$ -	\$ 82,695	\$ -	\$ 1,879,752
Equestrian center income		100,000	613,718			713,718
Swim club income		57,600		18,412		76,012
Tennis club income		62,567			84,318	146,885
Newsletter	90,538					90,538
Cell tower revenue	130,537					130,537
Interest	716	5,567				6,283
Maintenance revenue from Association			24,000			24,000
Other member income	178,184		129,541			307,725
Total revenues	<u>2,020,032</u>	<u>402,734</u>	<u>767,259</u>	<u>101,107</u>	<u>84,318</u>	<u>3,375,450</u>
Expenses						
Utilities						
Electricity and gas	7,759		14,859	47,064	29,048	98,730
Water and sewer	45,814		12,561	3,306	3,306	64,987
Trash removal	17,608			550	538	18,696
Telephone, cable, internet and website	7,031		2,765	2,664	2,680	15,140
	<u>78,212</u>	<u>-</u>	<u>30,185</u>	<u>53,584</u>	<u>35,572</u>	<u>197,553</u>
Common area and equestrian						
Landscape and irrigation	282,039		18,790	2,211	8,904	311,944
Tree trimming	96,440					96,440
Trail maintenance	157,145					157,145
Common area repairs and maintenance	27,074		72,234	9,098	11,426	119,832
Pool and spa				21,910		21,910
Pest control	18,328		6,400	764	1,884	27,376
Janitorial			1,465	9,157	4,348	14,970
Emergency preparedness and security	7,467					7,467
Feed and shavings			305,480			305,480
	<u>588,493</u>	<u>-</u>	<u>404,369</u>	<u>43,140</u>	<u>26,562</u>	<u>1,062,564</u>
Administrative						
Insurance	51,343		21,028	255		72,626
Accounting	44,896					44,896
Payroll and related expenses	611,580		296,903	1,511	11,934	921,928
Administrative expense	46,668		8,927	1,345	328	57,268
Newsletter expense	43,340					43,340
Legal and professional	196,237			10,912		207,149
Collection costs	996					996
Social activities	53,756					53,756
Property tax, Licenses and permits	760		475	693		1,928
Income tax expense	14,604					14,604
Bad debt expense (recoveries)	(6,277)					(6,277)
Capital expenditures	24,794		1,050	6,076		31,920
Depreciation expense	10,175		4,731	1,781	9,720	26,407
	<u>1,092,872</u>	<u>-</u>	<u>333,114</u>	<u>22,573</u>	<u>21,982</u>	<u>1,470,541</u>
Major repairs and replacements		204,631				204,631
Total expenses	<u>1,759,577</u>	<u>204,631</u>	<u>767,668</u>	<u>119,297</u>	<u>84,116</u>	<u>2,935,289</u>
Excess(deficit) of revenues over(under) expenses	260,455	198,103	(409)	(18,190)	202	440,161
Beginning fund balances	328,623	3,205,573	383,763	216,069	494,300	4,628,328
Ending fund balances	<u>\$ 589,078</u>	<u>\$ 3,403,676</u>	<u>\$ 383,354</u>	<u>\$ 197,879</u>	<u>\$ 494,502</u>	<u>\$ 5,068,489</u>

The accompanying notes are an integral part of the financial statements
(See Independent Auditor's Report)

NELLIE GAIL RANCH OWNERS' ASSOCIATION
STATEMENT OF CASH FLOWS
For the Year Ended September 30, 2016

	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>Equestrian Fund</u>	<u>Swim Fund</u>	<u>Tennis Fund</u>	<u>Total</u>
Excess(deficit) of revenues over(under) expenses	\$ 260,455	\$ 198,103	\$ (409)	\$ (18,190)	\$ 202	\$ 440,161
Adjustments to reconcile excess(deficit) of revenues over(under) expenses to net cash provided(used) by operating activities						
Assessments receivable	6,517	-	8,514	-	-	15,031
Allowance for doubtful accounts	(6,277)	-	-	-	-	(6,277)
Interest receivable	-	212	-	-	-	212
Other receivable	-	-	(2,500)	-	-	(2,500)
Prepaid insurance	(6,390)	-	5,936	-	-	(454)
Depreciation	10,175	-	4,731	1,780	9,720	26,406
Deferred expenses	(10,200)	-	-	-	-	(10,200)
Inventory	-	-	13,473	-	-	13,473
Accounts payable	29,336	-	175	-	(3,811)	25,700
Payroll payable	3,477	-	2,499	-	-	5,976
Prepaid assessments	127,999	-	2,732	-	-	130,731
Paid time off payable	(5,126)	-	3,489	-	-	(1,637)
Income taxes payable	1,671	-	-	-	-	1,671
Deposits	(206,903)	-	9,423	-	-	(197,480)
Net cash provided(used) by operating activities	<u>(55,721)</u>	<u>212</u>	<u>48,472</u>	<u>1,780</u>	<u>5,909</u>	<u>652</u>
Cash provided(used) by investing activities:						
Increase in investments	-	(275,000)	-	-	-	(275,000)
Net cash flows from investing activities	<u>-</u>	<u>(275,000)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(275,000)</u>
Cash provided(used) by financing activities:						
Interfund borrowings, net	-	-	-	-	-	-
Net cash flows from financing activities	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Net increase(decrease) in cash and cash equivalents	204,734	(76,685)	48,063	(16,410)	6,111	165,813
Cash and cash equivalents at beginning of year	723,060	1,953,792	268,373	122,740	311,112	3,379,077
Cash and cash equivalents at end of year	<u>\$ 927,794</u>	<u>\$ 1,877,107</u>	<u>\$ 316,436</u>	<u>\$ 106,330</u>	<u>\$ 317,223</u>	<u>\$ 3,544,890</u>
SUPPLEMENTAL DISCLOSURE						
Income taxes paid						<u>\$ 6,328</u>
Interest paid						<u>\$ -</u>

The accompanying notes are an integral part of the financial statements
(See Independent Auditor's Report)

NELLIE GAIL RANCH OWNERS' ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
For the Year Ended September 30, 2016

1. Organization

Nellie Gail Ranch Owners' Association (the "Association") was incorporated on November 19, 1976 as a mutual benefit corporation under the laws of California, for the purposes of maintaining and preserving common property. The Association consists of 1,407 residential homes and is located in Laguna Hills, California.

2. Summary of Significant Accounting Policies

Basis of Accounting

The Association maintains its financial records on the cash basis of accounting, which recognizes revenues when received and expenses when paid. Adjustments at the end of the fiscal year result in these financial statements being presented on the full accrual basis of accounting.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires the board of directors 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. Actual results could differ significantly from those estimates.

Fund Accounting

The Association uses fund accounting, which requires that funds, such as operating funds and funds designated for future major repairs and replacements, be classified separately for accounting and reporting purposes. Disbursements from the operating fund are generally at the discretion of the board of directors and property manager. Disbursements from the replacement fund require signatures from the board of directors or officers as specified by California Civil Code, and generally may be made only for designated purposes. The Association maintains additional funds for Equestrian, Swim and Tennis.

Investment Income

The board's policy is to account for interest income in the fund in which it is earned. The Association pays related income taxes from the operating fund.

Property, Equipment and Depreciation Policy

The Association has not capitalized real and personal common area property contributed by the developer. Property and equipment purchased by the association has been recorded at cost, and depreciated using the straight-line method over estimated useful lives ranging from five to thirty years.

Cash and Cash Equivalents

Cash and cash equivalents include the Association's cash, checking accounts, money market funds and investments in certificates of deposit with original maturities of 90 days or less.

Investments

Investments consist of certificates of deposit and other securities and investment accounts with original maturities of more than 90 days.

NELLIE GAIL RANCH OWNERS' ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
For the Year Ended September 30, 2016

Subsequent Events

Subsequent events have been evaluated through November 18, 2016, which is the date the financial statements were available to be issued.

3. Assessments and Assessments Receivable

Association members are subject to quarterly assessments of \$334 to provide funds for the Association's operating expenses, future capital acquisitions, and major repairs and replacements. Assessments receivable represent fees due from owners. The Association's governing documents provide for various collection remedies for delinquent assessments and fees, including filing of liens on an owner's unit, foreclosing on a unit owner, and obtaining a legal judgment on an owner's other assets. Any excess operating funds are retained at the end of the fiscal year for use in future periods. After the Association has exhausted all efforts to collect delinquent accounts, the Board of Directors may elect to write off uncollectible balances. The Association records an allowance for doubtful accounts to reflect an estimate of accounts that may not be collectible, which includes receivables greater than 90 days old.

4. 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 bank accounts and are generally not available for expenditures for normal operations.

The board of directors conducted a study in 2016 to estimate the remaining useful lives and the replacement costs of the components of common property. The table included in the unaudited supplementary information on Future Major Repairs and Replacements is based on this study.

The Association is funding such major repairs and replacements over the estimated useful lives of the components based on the study's estimates of current replacement costs, considering amounts previously accumulated in the replacement fund. Actual expenditures, however, may vary from estimated amounts and the variations may be material. Therefore, amounts accumulated in the replacement fund may not be adequate to meet future needs. If additional funds are needed, however, the Association has the right, subject to its governing documents, to increase regular assessments or to levy special assessments, or it may delay major repairs and replacements until funds are available.

5. Income Taxes

The Association has federal tax exempt status under Internal Revenue Code Section 501(c)(4), and is exempt from federal income taxes on all non-business activities. The Association has not met the criteria to file as a homeowners' association for its California income tax return, and is taxed as a regular corporation for state purposes. The Internal Revenue Service and the California Franchise Tax Board can examine the Association's income tax returns generally up to three years and four years, respectively. The Association has not been examined by taxing authorities. The Association's tax positions have been in place beyond the statutes of limitations; and the Board has considered that the tax positions the Association has taken will be sustained if examined by taxing authorities.

NELLIE GAIL RANCH OWNERS' ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
For the Year Ended September 30, 2016

6. Compensated Absence Liability

Employees of the Association are entitled to paid vacation, paid sick days and personal days off, depending on job classification, length of service, and other factors. The estimated liability for paid time off has been accrued in the amount of \$27,877.

7. Pension Plan

The Association's Simple IRA plan covers employees who have completed at least three months of service. The Association matches 100% of employee contributions up to 3% of compensation. The plan administrator is Assembly Pointe Financial. During the year ended September 30, 2016, the Association contributed \$14,610 to the plan.

8. Tennis, Swim Club and Equestrian Facilities License Agreements

In October 2011, the Association entered into an agreement to lease the tennis courts to provide services and/or conduct activities related to tennis instruction to the Members. The agreement was renewed in October 2013. The contract requires the lessee to pay a monthly usage fee of \$11,600.

In November 2011, the Association entered into a license agreement with a licensee to provide services and/or conduct activities related to swim program services to the Participant Members. The contract was renewed in October 2014, to extend the term through September 30, 2016. The Licensee is required to pay a flat monthly usage fee for swim team practice of \$1,750, as well as a monthly amount equivalent to 22% of the swim lesson revenues. In October 2014, the Association entered into an agreement with a second licensee for use of the swim facilities, which pays a flat monthly fee of \$2,550 and a usage fee of 20% of swim program revenues.

The Association entered into a license agreement in September 2015 with a licensee for the use of certain amenities and areas of the Association's equestrian facilities for the purpose of providing equestrian training and instruction. During the year ended September 30, 2016, the licensee paid a monthly fee of \$2,120. In October 2016, the Association renewed the one-year arrangement via a service agreement with Hayden Show Jumping and Riding School (Trainer), with monthly fees totaling \$2,220.

9. Contingent Liabilities and Litigation

The Association has ongoing claims made against it that result from the normal operations of the Association. The Association believes that it has adequate legal defense and insurance to be sufficiently protected from potentially adverse legal consequences.

10. Deferred Expenses

During the year ended September 30, 2016, the Association incurred clubhouse renovation architectural, permitting and other planning costs totaling \$97,483. These costs have been accounted for as work in progress, and will be recognized upon completion of the clubhouse renovation project.

NELLIE GAIL RANCH OWNERS' ASSOCIATION
SUPPLEMENTARY INFORMATION ON FUTURE MAJOR
REPAIRS AND REPLACEMENTS
For the Year Ended September 30, 2016
(Unaudited)

The Association's board of directors, in conjunction with a reserve study expert, conducted a study in 2016 to estimate the remaining useful lives and the replacement costs of the components of common property. Replacement costs were based on the estimated costs to repair or replace the common property components on the date of the study. The following information is based on the study and presents significant information about the components of common property.

Study Component - HOA	Estimated remaining useful lives	Estimated current replacement costs	Study recommended annual funding requirement	Study recommended fund balance
Asphalt	0-3	\$ 96,500	\$ 12,816	\$ 72,125
Monument	7-13	50,200	3,000	25,143
Concrete	0	3,000	3,396	3,000
Trail Fencing	4-8	1,005,000	75,792	694,334
Irrigation	0-11	36,500	3,444	21,083
Pedestals	16	30,000	1,692	6,000
Vehicles	1	38,500	4,356	34,650
Tractors	15	20,500	1,164	5,125
Solar Panels	11	40,500	3,060	10,800
Dapple Grey	0 - 7	158,925	13,416	116,328
Office	0 - 16	110,000	16,740	82,126
Events Shed	14	6,300	396	1,400
Gallup Park	0 - 20	148,869	11,400	92,746
Dumpster	2 - 7	5,050	1,020	892
Hidden Trail	3 - 5	73,400	7,560	44,811
Hundred Foot Arena	2 - 6	43,995	3,108	35,778
Moulton Park	0 - 18	137,225	9,636	109,846
Cabot Arena	0 - 16	85,850	6,156	52,383
Controller enclosures	4	87,500	4,128	72,917
Trees	0	30,000	1,692	30,000
Trail Engineering	0 - 1	208,000	-	179,750
Park electrical and lighting	0 - 3	61,500	3,228	52,950
		2,477,314	187,200	1,744,187
Study Component - Equine		1,581,400	135,600	1,038,585
Study Component - Swim		548,913	59,400	369,521
Study Component - Tennis		854,010	78,000	550,358
		\$ 5,461,637	\$ 460,200	\$ 3,702,651
				\$ 3,403,676
Replacement fund balance at September 30, 2016				
Other Assumptions:				
Interest rate				1.50%
Inflation rate				3.00%