

VanDerPol and Company

A Professional Accountancy Corporation

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors and the Owners
Talega Gallery - Seagarden Cost Center

Opinion

We have audited the accompanying financial statements of Talega Gallery - Seagarden Cost Center, which comprise the balance sheet as of March 31, 2022, and the related statements of revenues, expenses, and changes in fund balances and cash flows for the year then ended, and the related notes to the financial statements.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Talega Gallery - Seagarden Cost Center as of March 31, 2022, 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.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of Talega Gallery - Seagarden Cost Center and to meet our other ethical responsibilities in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for 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.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about Talega Gallery - Seagarden Cost Center's ability to continue as a going concern within one year after the date that the financial statements are available to be issued.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with generally accepted auditing standards will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements, including omissions, are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with generally accepted auditing standards, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit 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 Talega Gallery - Seagarden Cost Center's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about Talega Gallery - Seagarden Cost Center's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control related matters that we identified during the audit.

Disclaimer of Opinion on Required Supplementary Information

Accounting principles generally accepted in the United States of America require that information on future major repairs and replacements of common property on page 13 be presented to supplement the basic financial statements. Such information is the responsibility of management and, 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.

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Costa Mesa, California

June 22, 2022

TALEGA GALLERY - SEAGARDEN COST CENTER
BALANCE SHEET
AS OF MARCH 31, 2022

	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>Total</u>
ASSETS			
Cash and cash equivalents [Note 8]	\$ 4,065	\$ 24,239	\$ 28,304
Member assessments receivable	147	--	147
Investments [Note 9]	--	25,012	25,012
Other receivable	17	--	17
Prepaid insurance	422	--	422
	<u>422</u>	<u>--</u>	<u>422</u>
Total Assets	<u>\$ 4,651</u>	<u>\$ 49,251</u>	<u>\$ 53,902</u>
LIABILITIES			
Accounts payable and accrued expenses	\$ 650	\$ --	\$ 650
Prepaid assessments	1,107	--	1,107
Due to Talega Gallery	--	16	16
Contract liability [Note 4]	--	48,809	48,809
	<u>--</u>	<u>48,809</u>	<u>48,809</u>
Total Liabilities	1,757	48,825	50,582
FUND BALANCES	<u>2,894</u>	<u>426</u>	<u>3,320</u>
TOTAL LIABILITIES AND FUND BALANCES	<u>\$ 4,651</u>	<u>\$ 49,251</u>	<u>\$ 53,902</u>

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

TALEGA GALLERY - SEAGARDEN COST CENTER
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND BALANCES
FOR THE YEAR ENDED MARCH 31, 2022

	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>Total</u>
REVENUES			
Member assessments [Notes 3 & 4]	\$ 26,604	\$ 21,550	\$ 48,154
Investment income	--	7	7
Other income	<u>264</u>	<u>--</u>	<u>264</u>
Total Revenues	<u>26,868</u>	<u>21,557</u>	<u>48,425</u>
EXPENSES			
Utilities:			
Electricity	886	--	886
Water	6,073	--	6,073
Maintenance:			
Pest control	2,389	1,730	4,119
Other common area maintenance	2,625	--	2,625
Roof and related repairs	--	14,220	14,220
Building repairs	--	5,600	5,600
Administrative:			
Insurance	11,380	--	11,380
Professional fees	<u>4,245</u>	<u>--</u>	<u>4,245</u>
Total Expenses	<u>27,598</u>	<u>21,550</u>	<u>49,148</u>
EXCESS OF REVENUES OVER/(UNDER) EXPENSES	(730)	7	(723)
Beginning Fund Balances	<u>3,624</u>	<u>419</u>	<u>4,043</u>
Ending Fund Balances	<u><u>\$ 2,894</u></u>	<u><u>\$ 426</u></u>	<u><u>\$ 3,320</u></u>

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

TALEGA GALLERY - SEAGARDEN COST CENTER
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED MARCH 31, 2022

	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>Total</u>
Cash flows from operating activities			
Excess of revenues over/(under) expenses	\$ (730)	\$ 7	\$ (723)
Adjustments to reconcile excess of revenues over/(under) expenses to net cash provided/(used) by operating activities:			
Increase in member assessments receivable	(147)	--	(147)
Increase in other receivable	(17)	--	(17)
Decrease in prepaid insurance	453	--	453
Decrease in accounts payable	(616)	(2,625)	(3,241)
Increase in prepaid assessments	8	--	8
Decrease in due to Talega Gallery	(400)	--	(400)
Increase in contract liability	--	3,506	3,506
Net cash provided/(used) by investing activities	<u>(1,449)</u>	<u>888</u>	<u>(561)</u>
Cash flows from investing activities			
Interest reinvested in mutual funds	<u>--</u>	<u>(5)</u>	<u>(5)</u>
Net cash used by investing activities	<u>--</u>	<u>(5)</u>	<u>(5)</u>
Net increase/(decrease) in cash	(1,449)	883	(566)
Cash at beginning of year	<u>5,514</u>	<u>23,356</u>	<u>28,870</u>
Cash at end of year	<u><u>\$ 4,065</u></u>	<u><u>\$ 24,239</u></u>	<u><u>\$ 28,304</u></u>

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

TALEGA GALLERY - SEAGARDEN COST CENTER
NOTES TO FINANCIAL STATEMENTS
MARCH 31, 2022

NOTE 1. ORGANIZATION

Talega Gallery – Seagarden Cost Center [Cost Center] was established in 2001 as a separate entity under the corporate veil of the Talega Gallery Community Cost Center [Talega Gallery]. The purpose of the Cost Center is to separately account for additional assessments collected from 41 owners within the Seagarden Tract of Talega Gallery, located in San Clemente, California. The additional assessments are collected in order to provide for certain maintenance items pertaining only to the Seagarden homes.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Accounting - The books and records for the Cost Center are maintained on the accrual basis of accounting. The tax returns are also reported on the accrual basis of accounting.

Capitalization Policy and Depreciation - In accordance with industry standards, the Cost Center has not capitalized in the financial statements the common area real property acquired at its inception from the developer. Replacements and improvements to the real property which are directly associated with the units are also not capitalized. They are instead charged directly to either the Operating Fund or the Replacement Fund in the period they are incurred.

Significant capital assets not directly associated with the units, referred to as personal property assets, are capitalized and depreciated over their estimated useful life using the straight-line method of depreciation. During the year ended March 31, 2022, there were no significant personal property additions.

Fund Accounting - The Cost Center's accompanying financial statements have been prepared using fund accounting. Under this method of accounting, financial resources are separated into two categories, the Operating Fund and the Replacement Fund. Disbursements from the Replacement Fund generally may be made only for designated repair or replacement of major common area components. Disbursements from the Operating Fund are at the discretion of the Board of Directors and generally are for on-going repairs, maintenance, and administrative functions.

Investment Income - The Board's policy is to allocate interest earned on Replacement Fund cash accounts to the Replacement Fund, and to pay the related income taxes out of the Replacement Fund when reimbursing Talega Gallery.

Use of Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 period. Actual results could differ from those estimates.

NOTE 3. ASSESSMENTS AND ASSESSMENTS RECEIVABLE

Cost Center members are subject to paying assessments to fund the Cost Center's operating expenses, future capital acquisitions, and major repairs and replacements. Assessment revenue is recognized as the related performance obligation that satisfies the transaction amount, which is expected to be collected.

TALEGA GALLERY - SEAGARDEN COST CENTER
NOTES TO FINANCIAL STATEMENTS
MARCH 31, 2022

NOTE 3. ASSESSMENTS AND ASSESSMENTS RECEIVABLE – (CONTINUED)

Under the revenue recognition standard of ASC 606 [Note 5], the Cost Center (an entity) has a performance obligation to the unit/unit owners (customers). The Cost Center's approved annual Operating Fund budget establishes the maintenance, management, and administrative services that the Cost Center is obligated to perform. These services can be bundled together as a single commercial objective and a single performance obligation. The budget establishes an implied contract price, and because these services are provided within an annual cycle, the respective Operating Fund assessments are considered revenue for the current period.

The performance obligations related to Replacement Fund assessments are satisfied when these financial resources are expended for their designated purpose.

For the year ended March 31, 2022, the Cost Center's monthly assessment was \$105 per unit. For the fiscal year ending March 31, 2023, the monthly assessment has been raised to \$125 per unit.

Assessments receivable at March 31, 2022 represent assessments and other fees due from owners. The Cost Center's governing documents provide for various collection remedies for delinquent assessments, including filing of liens on the owner's unit, foreclosing on the unit owner, or obtaining judgment on other assets of the unit owner.

Under ASC 606, assessments and other fees that cannot be collected with certainty are now charged against the respective revenue rather than bad debt expense. Bad debt expense will still be used to account for uncollectible receivable balances that were recorded in prior periods.

NOTE 4. CONTRACT LIABILITY

The Cost Center recognizes revenue from members as the related performance obligations are satisfied. A contract liability is recorded when the Cost Center has the right to receive payment in advance of the satisfaction of performance obligations which specifically pertains to Replacement Fund assessments. For the year ended March 31, 2022, the Cost Center assessed and allocated \$25,056 to the Replacement Fund. The contract liability balance at the beginning of the year and end of the year was \$45,303 and \$48,809, respectively, resulting in a \$3,506 increase.

NOTE 5. REVENUE RECOGNITION

The Financial Accounting Standards Board (FASB) issued guidance in the Accounting Standards Codification (ASC) Topic 606 Revenue from Contracts with Customers. FASB ASC 606 is a revenue recognition standard that affects businesses that enter into contracts with customers to transfer goods and services, including public, private and non-public entities. The purpose of the standard is to eliminate variations in the way businesses across industries handle accounting for similar transactions.

TALEGA GALLERY - SEAGARDEN COST CENTER
NOTES TO FINANCIAL STATEMENTS
MARCH 31, 2022

NOTE 6. REPLACEMENT FUNDING PROGRAM

In accordance with the Cost Center's governing documents, which require that funds be accumulated for future major repairs and replacements, the Cost Center has established certain amounts as reserves for future capital expenditures. Members' assessments relating to the replacement funding program are considered capital contributions from members' dues and as such are restricted in usage. Disbursements are to be made only if specifically approved by the Board of Directors.

An independent study of the Cost Center's replacement funding program was conducted in December 2021 and recommends a contribution to the Replacement Fund of approximately \$33,000 (\$67.07 per unit per month) for the fiscal year ending March 31, 2023 using the "directed cash flow" method. The study's recommendations were based on estimates of remaining useful lives, current replacement costs, and amounts accumulated in the Replacement Fund. For the year ended March 31, 2022, the Cost Center funded \$25,056 from assessments to the Replacement Fund. The 2022/2023 budget includes a provision for replacement funding of \$33,200 (\$67.48 per unit per month). The table included in the unaudited supplementary information on future major repairs and replacements is based on the study.

The Cost Center 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 may vary from the estimated amounts and the variations may be material. Therefore, amounts collected for replacement obligations may not be adequate to meet all future needs for major repairs and replacements. If additional funds are needed, the Cost Center has the right, subject to the Cost Center's governing documents, to pass special assessments, increase monthly assessments, or delay replacement until funds are available.

NOTE 7. INCOME TAXES

The financial records of the Cost Center are combined with those of Talega Gallery for income tax reporting purposes. The resulting tax liability is initially paid by Talega Gallery and allocated to the Cost Center proportionately. For the year ended March 31, 2022, there was no tax expense.

The Cost Center utilizes the liability method of accounting for income taxes. Under the liability method deferred income tax assets and liabilities are provided based on the difference between the financial statements and tax basis of assets and liabilities measured by the currently enacted tax rates in effect for the years in which these differences are expected to reverse. Because there is no material difference between the financial accounting and tax basis of the Cost Center's assets and liabilities, the Cost Center has not recorded any deferred tax assets or liabilities.

The Cost Center has adopted accounting standards for the accounting for uncertainty in income taxes. These standards provide guidance for the accounting and disclosure about uncertain tax positions taken by an association. Management believes that all of the positions taken by the Cost Center in its federal and state income tax returns are more likely than not to be sustained upon examination. The Cost Center's tax returns are subject to examination by the Internal Revenue Service and the California Franchise Tax Board, generally for three years and four years, respectively after they are filed.

TALEGA GALLERY - SEAGARDEN COST CENTER
NOTES TO FINANCIAL STATEMENTS
MARCH 31, 2022

NOTE 8. SCHEDULE OF CASH BALANCES

Generally, certificates of deposit and other debt securities with original maturities less than 90 days are considered cash equivalents, while certificates of deposits and debt securities with maturities over 90 days are considered "investments."

At March 31, 2022, the Cost Center maintained cash balances at the following institutions:

Operating Fund:

Pacific Western Bank - checking	<u>\$ 4,065</u>
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Replacement Fund:

Morgan Stanley - money funds	<u>\$ 24,239</u>
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NOTE 9. INVESTMENTS

The Cost Center's investments consist of open end non-sweep treasury security mutual funds. Investment income from these investments is recorded when earned. The investments are considered to be held to maturity and are carried at cost, which approximates the fair value. At March 31, 2022, the Association's investments totaled \$25,012.

NOTE 10. SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

There were no cash payments for income taxes for the year ended March 31, 2022. No interest was paid and there were no non-cash investing or financing transactions during the year.

NOTE 11. CONTINGENCY

The COVID-19 pandemic developed rapidly in 2020. Measures taken by various governments to contain the virus have affected economic activity. As a result, economic uncertainties have arisen. The financial impact, if any, and overall effects to the Cost Center cannot be reasonably estimated at this time.

NOTE 12. SUBSEQUENT EVENTS

Subsequent events have been evaluated through June 22, 2022, which is the date the financial statements were available to be issued.

TALEGA GALLERY - SEAGARDEN COST CENTER
REQUIRED SUPPLEMENTARY INFORMATION
ON FUTURE MAJOR REPAIRS & REPLACEMENTS
AS OF MARCH 31, 2022
(UNAUDITED)

An independent reserve study was conducted in December 2021 to estimate the remaining useful lives and the replacement costs of the components of common property. The study was based upon representations by the Board of Directors and the experience and knowledge of the independent reserve analyst. The estimates were based on current replacement costs adjusted for a thirty-year average annual inflation rate of 2.5%. These estimates are used as a foundation in arriving at recommended funding requirements, based upon cash and investments which have been collected for future repairs and replacements.

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

Common Area Component	Estimated Remaining Useful Lives	Estimated Current Replacement Costs	2022/2023 Recommended Funding Requirement	Study's Recommended Fund Balance
Roofs	0-1 years	\$ 17,000	\$ 12,972	\$ 16,000
Painting	0-4 years	62,308	11,997	43,103
Building inspection	0 years	2,500	2,024	2,500
Fire system test	0 years	2,000	340	2,000
Wood repairs	0 years	2,500	2,024	2,500
Weepscreed repairs	0 years	2,500	2,024	2,500
Termite inspection	0 years	2,000	1,619	2,000
	Total	\$ 90,808	\$ 33,000	\$ 70,603
The accumulated contract liability and Replacement Fund balance at 3/31/22:				\$ 49,235