

**THE FOREST HIGHLANDS
ASSOCIATION AND SUBSIDIARIES**

FINANCIAL STATEMENTS
DECEMBER 31, 2019 AND 2018

Together with Independent Auditors' Report

INDEPENDENT AUDITORS' REPORT

To the Members of *The Forest Highlands Association and Subsidiaries*
Flagstaff, Arizona

Report on the Financial Statements

We have audited the accompanying financial statements of *The Forest Highlands Association and Subsidiaries*, which comprise the consolidating balance sheet as of December 31, 2019 and consolidated balance sheet as of December 31, 2018, and the related consolidating and consolidated statements of assessments, revenues, and expenses, members' equity, and cash flows for the years 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.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits 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 *The Forest Highlands Association and Subsidiaries* as of December 31, 2019 and 2018 and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Emphasis of Matter

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. We have not applied procedures to determine whether the funds designated for future major repairs and replacements as discussed in Note 4 are adequate to meet such future costs because that determination is outside the scope of our audits. Our opinion on the financial statements is not modified with respect to this matter.

Disclaimer of Opinion on Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the information on future major repairs and replacements on pages 12-13 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, 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 audits 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.

Barry & Moore CPAs, PLC
Phoenix, Arizona
March 25, 2020

Barry & Moore CPAs, PLC

THE FOREST HIGHLANDS ASSOCIATION AND SUBSIDIARIES
BALANCE SHEETS
DECEMBER 31, 2019 AND 2018

	CONSOLIDATING					CONSOLIDATED	
	ASSOCIATION	WATER COMPANY	WASTEWATER COMPANY	FHEAGO	ELIMINATIONS	2019	2018
<u>ASSETS</u>							
CURRENT ASSETS:							
Cash	\$ 97,488	\$ 19,972	\$ 594,261	\$ 69,422	\$ -	\$ 781,143	\$ 804,602
Investments:							
Reserve Fund	6,931,583	-	-	-	-	6,931,583	4,949,361
Capital Fund	1,000,000	-	-	-	-	1,000,000	500,000
Operating Fund	759,955	-	-	-	-	759,955	681,515
Member receivables, net of the allowance for uncollectible accounts of \$32,266 in 2019 and \$18,632 in 2018	281,931	16,644	-	-	-	298,575	122,630
Other receivables	185,719	2,011	20,000	-	-	207,730	224,163
Intercompany receivables	137,162	-	156,092	-	(293,254)	-	-
Inventories	417,612	842	-	-	-	418,454	395,445
Prepaid expenses	212,715	-	-	-	-	212,715	158,801
Total current assets	10,024,165	39,469	770,353	69,422	(293,254)	10,610,155	7,836,517
INVESTMENTS IN SUBSIDIARIES:							
Forest Highlands Water Company	309,662	-	-	-	(309,662)	-	-
Forest Highlands Wastewater Reclamation Company	2,433,462	-	-	-	(2,433,462)	-	-
FH Education & Amateur Golf Organization	67,176	-	-	-	(67,176)	-	-
Total investments in subsidiaries	2,810,300	-	-	-	(2,810,300)	-	-
PROPERTY AND EQUIPMENT:							
Contributed assets:							
Golf course land and improvements	17,925,056	-	-	-	-	17,925,056	17,925,056
Common area land and improvements	1,870,832	-	-	-	-	1,870,832	1,870,832
Golf course equipment	728,000	-	-	-	-	728,000	728,000
Clubhouse and furnishings	9,330,088	-	-	-	-	9,330,088	9,330,088
Utilities	-	5,642,728	6,626,836	-	-	12,269,564	12,269,564
Purchased assets:							
Golf course improvements	5,991,902	-	-	-	-	5,991,902	5,985,302
Buildings and improvements	14,759,916	-	-	-	-	14,759,916	13,875,406
Vehicles	674,242	-	-	-	-	674,242	607,547
Natural gas facilities	6,941	-	-	-	-	6,941	13,941
Furnishings and equipment	10,443,449	-	-	-	-	10,443,449	9,768,882
Common area land improvements	3,801,837	-	-	-	-	3,801,837	3,820,894
Utilities	-	1,624,571	2,862,834	-	-	4,487,405	4,412,984
Total property and equipment	65,532,263	7,267,299	9,489,670	-	-	82,289,232	80,608,496
Less - accumulated depreciation	(25,325,525)	(5,227,204)	(7,063,940)	-	-	(37,616,669)	(35,452,555)
Net property and equipment	40,206,738	2,040,095	2,425,730	-	-	44,672,563	45,155,941
TOTAL ASSETS	\$ 53,041,203	\$ 2,079,564	\$ 3,196,083	\$ 69,422	\$ (3,103,554)	\$ 55,282,718	\$ 52,992,458

See accompanying notes and independent auditors' report

THE FOREST HIGHLANDS ASSOCIATION AND SUBSIDIARIES
BALANCE SHEETS *(Continued)*
DECEMBER 31, 2019 AND 2018

	CONSOLIDATING					CONSOLIDATED	
	ASSOCIATION	WATER COMPANY	WASTEWATER COMPANY	FHEAGO	ELIMINATIONS	2019	2018
<u>LIABILITIES AND MEMBERS' EQUITY</u>							
CURRENT LIABILITIES:							
Accounts payable	\$ 39,725	\$ 397	\$ 3,760	\$ -	\$ -	\$ 43,882	\$ 152,714
Accrued liabilities	685,592	42,835	11,974	-	-	740,401	834,783
Prepaid member assessments	421,800	-	-	-	-	421,800	476,525
Capital lease obligation, current portion	29,549	-	-	-	-	29,549	-
Intercompany payables	-	231,480	59,528	2,246	(293,254)	-	-
Total current liabilities	1,176,666	274,712	75,262	2,246	(293,254)	1,235,632	1,464,022
CAPITAL LEASE OBLIGATION, NONCURRENT PORTION	120,503	-	-	-	-	120,503	-
CONTRIBUTIONS IN AID OF CONSTRUCTION, NET	-	1,495,188	687,361	-	-	2,182,549	2,370,268
Total liabilities	1,297,169	1,769,900	762,623	2,246	(293,254)	3,538,684	3,834,290
MEMBERS' EQUITY:							
Common stock	-	4,861,824	3,050,908	-	(7,912,732)	-	-
Additional paid-in capital	50,528,758	1,540,057	4,622,059	70,435	(6,232,551)	50,528,758	50,478,759
Accumulated losses	(33,721,800)	(6,092,217)	(5,239,507)	(3,259)	11,334,983	(33,721,800)	(33,217,534)
Capital contribution fees	25,633,218	-	-	-	-	25,633,218	22,708,718
Capital improvement assessments	9,294,905	-	-	-	-	9,294,905	9,294,905
Unrealized gain (loss) on investments	8,953	-	-	-	-	8,953	(106,680)
Total members' equity	51,744,034	309,664	2,433,460	67,176	(2,810,300)	51,744,034	49,158,168
TOTAL LIABILITIES AND MEMBERS' EQUITY	<u>\$ 53,041,203</u>	<u>\$ 2,079,564</u>	<u>\$ 3,196,083</u>	<u>\$ 69,422</u>	<u>\$ (3,103,554)</u>	<u>\$ 55,282,718</u>	<u>\$ 52,992,458</u>

See accompanying notes and independent auditors' report

THE FOREST HIGHLANDS ASSOCIATION AND SUBSIDIARIES
STATEMENTS OF ASSESSMENTS, REVENUES, AND EXPENSES
FOR THE YEARS ENDED DECEMBER 31, 2019 AND 2018

	CONSOLIDATING					CONSOLIDATED	
	ASSOCIATION	WATER COMPANY	WASTEWATER COMPANY	FHEAGO	ELIMINATIONS	2019	2018
ASSESSMENTS AND REVENUES:							
Member assessments	\$ 9,120,654	\$ -	\$ -	\$ -	\$ -	\$ 9,120,654	\$ 8,315,860
Food and beverage	1,979,220	-	-	52,397	-	2,031,617	1,882,116
Golf operations	1,663,035	-	-	20,928	-	1,683,963	1,675,049
Recreation	447,393	-	-	-	-	447,393	415,393
Safety and compliance	417,478	-	-	-	-	417,478	407,857
Residential and commercial water	-	399,257	-	-	(36,769)	362,488	370,641
Irrigation	-	59,186	-	-	(59,186)	-	-
Wastewater service	-	-	433,041	-	-	433,041	435,429
Sewer tap-in fees	-	-	284,000	-	-	284,000	200,000
Contributions	-	-	-	167,282	-	167,282	9,044
Other	409,962	45,378	23,262	18,500	(89,184)	407,918	310,475
Net gain on investments in subsidiaries	1,860	-	-	-	(1,860)	-	-
Total assessments and revenues	<u>14,039,602</u>	<u>503,821</u>	<u>740,303</u>	<u>259,107</u>	<u>(186,999)</u>	<u>15,355,834</u>	<u>14,021,864</u>
EXPENSES:							
Food and beverage	3,145,533	-	-	-	-	3,145,533	2,860,408
Golf operations	2,249,209	-	-	-	-	2,249,209	2,241,850
Golf course maintenance	2,344,994	-	-	-	(95,955)	2,249,039	2,331,495
General and administrative	2,037,204	-	-	-	-	2,037,204	2,008,075
Recreation	1,058,132	-	-	-	-	1,058,132	960,808
Common area maintenance	852,925	-	-	-	-	852,925	747,519
Safety and compliance	844,295	-	-	-	-	844,295	724,956
Operating expenses	-	509,062	491,966	262,410	(89,184)	1,174,254	876,728
Total expenses	<u>12,532,292</u>	<u>509,062</u>	<u>491,966</u>	<u>262,410</u>	<u>(185,139)</u>	<u>13,610,591</u>	<u>12,751,839</u>
OPERATING INCOME (LOSS)	1,507,310	(5,241)	248,337	(3,303)	(1,860)	1,745,243	1,270,025
OTHER INCOME (EXPENSE), NET	242,994	(8,432)	39	44	-	234,645	(685,990)
PROVISION FOR UNCOLLECTIBLE RECEIVABLES	(12,000)	-	-	-	-	(12,000)	(9,750)
DEPRECIATION EXPENSE	<u>(2,220,686)</u>	<u>(114,056)</u>	<u>(115,528)</u>	<u>-</u>	<u>-</u>	<u>(2,450,270)</u>	<u>(2,296,685)</u>
EXCESS (DEFICIENCY) OF ASSESSMENTS AND REVENUES OVER EXPENSES	<u>\$ (482,382)</u>	<u>\$ (127,729)</u>	<u>\$ 132,848</u>	<u>\$ (3,259)</u>	<u>\$ (1,860)</u>	<u>\$ (482,382)</u>	<u>\$ (1,722,400)</u>

See accompanying notes and independent auditors' report

THE FOREST HIGHLANDS ASSOCIATION AND SUBSIDIARIES
CONSOLIDATING STATEMENTS OF MEMBERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2019 AND 2018

	<u>ASSOCIATION</u>	<u>WATER COMPANY</u>	<u>WASTEWATER COMPANY</u>	<u>FHEAGO</u>	<u>ELIMINATIONS</u>	<u>CONSOLIDATED</u>
MEMBERS' EQUITY, JANUARY 1, 2018	\$ 49,089,563	\$ 337,280	\$ 2,227,224	\$ 66,980	\$ (2,631,484)	\$ 49,089,563
CAPITAL CONTRIBUTION FEES	1,702,800	-	-	-	-	1,702,800
SPECIAL MEMBERSHIP FEES	170,000	-	-	-	-	170,000
UNREALIZED LOSS ON INVESTMENTS	(81,795)	-	-	-	-	(81,795)
EXCESS (DEFICIENCY) OF ASSESSMENTS AND REVENUES OVER EXPENSES	<u>(1,722,400)</u>	<u>(74,035)</u>	<u>73,388</u>	<u>3,455</u>	<u>(2,808)</u>	<u>(1,722,400)</u>
MEMBERS' EQUITY, DECEMBER 31, 2018	49,158,168	263,245	2,300,612	70,435	(2,634,292)	49,158,168
CAPITAL CONTRIBUTION FEES	2,924,500	-	-	-	-	2,924,500
SPECIAL MEMBERSHIP FEE	50,000	-	-	-	-	50,000
ADDITIONAL PAID-IN CAPITAL	-	174,148	-	-	(174,148)	-
UNREALIZED GAIN ON BONDS	93,748	-	-	-	-	93,748
EXCESS (DEFICIENCY) OF ASSESSMENTS AND REVENUES OVER EXPENSES	<u>(482,382)</u>	<u>(127,729)</u>	<u>132,848</u>	<u>(3,259)</u>	<u>(1,860)</u>	<u>(482,382)</u>
MEMBERS' EQUITY, DECEMBER 31, 2019	<u>\$ 51,744,034</u>	<u>\$ 309,664</u>	<u>\$ 2,433,460</u>	<u>\$ 67,176</u>	<u>\$ (2,810,300)</u>	<u>\$ 51,744,034</u>

See accompanying notes and independent auditors' report

THE FOREST HIGHLANDS ASSOCIATION AND SUBSIDIARIES
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2019 AND 2018

	CONSOLIDATING					CONSOLIDATED	
	ASSOCIATION	WATER COMPANY	WASTEWATER COMPANY	FHEAGO	ELIMINATIONS	2019	2018
CASH FLOWS FROM OPERATING ACTIVITIES:							
Excess (deficiency) of assessments and revenues over expenses	\$ (482,382)	\$ (127,729)	\$ 132,848	\$ (3,259)	\$ (1,860)	\$ (482,382)	\$ (1,722,400)
Adjustments to reconcile excess (deficiency) of assessments and revenues over expenses to net cash flows from operations:							
Items not requiring an outlay of cash:							
Net gain on investments	(54,629)	-	-	-	-	(54,629)	-
Net gain on investments in subsidiaries	(1,860)	-	-	-	1,860	-	-
Depreciation expense	2,220,686	114,056	115,528	-	-	2,450,270	2,296,685
(Gain) loss on disposal of property and equipment	10,058	7,687	-	-	-	17,745	824,779
(Increase) decrease in:							
Member receivables, net	(74,007)	(4,938)	-	-	-	(78,945)	69,232
Other receivables	32,440	3,993	-	-	-	36,433	(194,458)
Inventories	(30,565)	(164)	7,722	-	-	(23,007)	(41,377)
Prepaid expenses	(75,142)	1,228	-	-	-	(73,914)	(73,651)
Increase (decrease) in:							
Accounts payable	(108,409)	(2,939)	2,516	-	-	(108,832)	(90,695)
Accrued liabilities	(79,049)	(9,322)	(6,011)	-	-	(94,382)	(18,965)
Prepaid member assessments	(54,725)	-	-	-	-	(54,725)	(2,695)
Net cash flows from operating activities	<u>1,302,416</u>	<u>(18,128)</u>	<u>252,603</u>	<u>(3,259)</u>	<u>-</u>	<u>1,533,632</u>	<u>1,046,455</u>
CASH FLOWS FROM INVESTING ACTIVITIES:							
Reserve Fund	(1,563,090)	-	-	-	-	(1,563,090)	(348,614)
Capital Fund	(152,255)	-	-	-	-	(152,255)	(182,174)
Operating Fund	8,296	-	-	-	-	8,296	4,143
Intercompany receivables	(60,698)	-	74,415	-	(13,717)	-	-
Investments in subsidiaries	(174,148)	-	-	-	174,148	-	-
Investment in natural gas facilities	7,000	-	-	-	-	7,000	29,000
Proceeds from sales of property and equipment	1,750	9,686	-	-	-	11,436	4,000
Purchases of property and equipment	(1,772,288)	(177,314)	(79,307)	-	-	(2,028,909)	(1,952,258)
Net cash flows from investing activities	<u>(3,705,433)</u>	<u>(167,628)</u>	<u>(4,892)</u>	<u>-</u>	<u>160,431</u>	<u>(3,717,522)</u>	<u>(2,445,903)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:							
Intercompany payables	-	(40,927)	27,969	(759)	13,717	-	-
Repayment on line of credit	-	-	-	-	-	-	(800,000)
Principal payments under capital lease obligation	(11,833)	-	-	-	-	(11,833)	-
Contributed capital	-	174,148	-	-	(174,148)	-	-
Special membership fees collected	50,000	-	-	-	-	50,000	170,000
Capital contribution fees collected	2,827,500	-	-	-	-	2,827,500	1,702,800
Capital improvement assessments collected	-	-	-	-	-	-	76,250
Net cash flows from financing activities	<u>2,865,667</u>	<u>133,221</u>	<u>27,969</u>	<u>(759)</u>	<u>(160,431)</u>	<u>2,865,667</u>	<u>1,149,050</u>
NET CHANGE IN CASH AND CASH EQUIVALENTS	<u>462,650</u>	<u>(52,535)</u>	<u>275,680</u>	<u>(4,018)</u>	<u>-</u>	<u>681,777</u>	<u>(250,398)</u>
CASH AND CASH EQUIVALENTS, beginning of year	<u>2,308,069</u>	<u>72,507</u>	<u>318,581</u>	<u>73,440</u>	<u>-</u>	<u>2,772,597</u>	<u>3,022,995</u>
CASH AND CASH EQUIVALENTS, end of year	<u>\$ 2,770,719</u>	<u>\$ 19,972</u>	<u>\$ 594,261</u>	<u>\$ 69,422</u>	<u>\$ -</u>	<u>\$ 3,454,374</u>	<u>\$ 2,772,597</u>

See accompanying notes and independent auditors' report

THE FOREST HIGHLANDS ASSOCIATION AND SUBSIDIARIES
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2019 AND 2018

(1) ORGANIZATION AND OPERATIONS:

The Forest Highlands Association was formed as a nonprofit Arizona corporation in 1987 to operate and maintain the common areas at Forest Highlands. Forest Highlands is a master planned residential golf club community located in Coconino County, Arizona, approximately six miles south of the City of Flagstaff, Arizona. Forest Highlands consists of approximately 1,100 acres and has 847 members.

The Forest Highlands Association was established by the Declaration of Covenants, Conditions and Restrictions for Forest Highlands and the Articles of Incorporation of The Forest Highlands Association. Operations are governed by the Bylaws of The Forest Highlands Association. Membership is mandatory by virtue of ownership of a lot at Forest Highlands. A nine-member Board of Directors, elected by the membership, manages the Association in accordance with the governing documents and applicable statutes.

The common areas at Forest Highlands for which The Forest Highlands Association is responsible consist of land, roads, golf courses, clubhouses, recreation facilities, drainage systems, water facilities, wastewater facilities, office space, and equipment storage facilities. Much of the property was conveyed by the developer.

The accompanying financial statements include the accounts of The Forest Highlands Association and its subsidiaries (collectively, the Association), Forest Highlands Water Company, Forest Highlands Wastewater Reclamation Company, and FH Education & Amateur Golf Organization. All material intercompany transactions have been eliminated in consolidation.

Forest Highlands Water Company was formed as a for-profit Arizona corporation in 1987 to provide water services at Forest Highlands.

Forest Highlands Wastewater Reclamation Company was formed as a nonprofit Arizona corporation in 1988 to provide wastewater services at Forest Highlands.

FH Education & Amateur Golf Organization was formed as a nonprofit Arizona corporation in 2016 to provide education scholarships and amateur golf events. FH Education & Amateur Golf Organization is a public charity under Internal Revenue Code section 501(c)(3).

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Basis of Presentation-

The accompanying financial statements have been prepared on the accrual basis of accounting in accordance with U.S. generally accepted accounting policies (GAAP).

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued):

Estimates-

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions. These affect the reported amounts of 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 from these estimates.

Cash-

In November 2016, the Financial Accounting Standards Board issued Accounting Standards Update No. 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash*. The standard requires the statement of cash flows to present the change in the total of cash, cash equivalents, restricted cash, and restricted cash equivalents. The Association adopted the standard on January 1, 2019 using the retrospective transition method. This resulted in including restricted cash and restricted cash equivalents in the statements of cash flows.

Investments-

In January 2016, the Financial Accounting Standards Board issued Accounting Standards Update No. 2016-01, *Financial Instruments – Overall (Topic 825): Recognition and Measurement of Financial Assets and Financial Liabilities*. Most notably for the Association, the standard requires equity investments (except those that are consolidated) to be measured at fair value with changes in fair value recognized in net income. The Association adopted the standard on January 1, 2019 using the modified retrospective transition method. This resulted in a \$21,885 reclassification of net unrealized loss on bond funds and equity funds from accumulated other comprehensive income to opening accumulated losses.

The Association's investments consist of cash, money market funds, bonds, bond funds, and equity funds. Investments are stated at fair value. Interest, dividends, realized gains and losses, unrealized gains and losses on bond funds and equity funds, and account fees are included in other income. Dividends earned are reinvested in the respective funds. Unrealized gains and losses on bonds are included as a separate component of members' equity until realized.

Member Receivables-

The Association provides an allowance for uncollectible accounts on member receivables based on a review of the current status of existing receivables and historical collection experience. Receivables are charged to the allowance when accounts are deemed to be uncollectible. Member receivables over 90 days past due are considered delinquent. Delinquent receivables are written off based on management's evaluation of individual member circumstances. At December 31, 2019 and 2018, respectively, there were \$19,244 and \$8,928 of member receivables over 90 days past due.

Inventories-

Inventories are stated at the lower of cost or market value, using the average cost method.

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued):

Property and Equipment-

Property and equipment include those assets purchased or constructed by the Association and assets that were purchased or constructed by the developer and subsequently contributed to the Association. Property and equipment are recorded at the cost to the Association or the developer.

Depreciation is determined on the straight-line method over the following estimated useful lives:

	<u>Years</u>
Furnishings and equipment	3-30
Vehicles	5
Improvements	5-40
Buildings and wells	5-50

Valuation of Long-Lived Assets-

Management periodically evaluates the carrying value of long-lived assets when events and circumstances warrant such a review. If the carrying value of a long-lived asset is considered impaired, a loss is recognized based on the amount by which the carrying value exceeds the fair market value. Management does not believe impairment existed at December 31, 2019.

Recognition of Membership Assessments-

Member assessments are billed and recognized as revenue monthly. Any prepaid amounts are recorded as prepaid member assessments until the respective month. Any unpaid amounts are recorded as member receivables until collected. Membership assessments are exempt from sales taxes. The Association experiences minimal bad debts as it can lien properties and obtain personal judgements.

Recognition of Revenues-

In May 2014, the Financial Accounting Standards Board issued Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*. The standard outlines a comprehensive model for accounting for revenue from contracts with customers. The Association adopted the standard on January 1, 2019. The Association determined that the revenue recognized under the new standard is the same as it recognized under previous guidance. As a result, there is no impact on its results of operations or cash flows. The Association has complied with the new disclosure requirements included in this standard.

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued):

Recognition of Revenues (Continued)-

Revenues consist of merchandise sales and fees for use of amenities, facilities, and services. All revenues associated with specific consumption and usage are recognized at a point in time when the customer takes physical possession of the merchandise or the service is provided because the risks and rewards of ownership transfer to the customer who obtains the benefit and has a present obligation to pay. Taxes the Association collects concurrent with revenue-producing activities are excluded from revenues. The Association experiences minimal returns, warranty claims, and bad debts.

Contributions are recorded as revenue when received. FH Education & Amateur Golf Organization has no revenue or net assets with donor restrictions.

(3) CASH:

Total cash and cash equivalents per the statements of cash flows is included in the balance sheets within the following line items at December 31:

	<u>2019</u>	<u>2018</u>
Cash	\$ 781,143	\$ 804,602
Investments:		
Reserve Fund:		
Cash	1,631,811	757,592
Cash equivalents	443,554	983,320
Capital Fund:		
Cash	492,681	91,588
Cash equivalents	42,459	95,807
Operating Fund:		
Cash equivalents	62,726	39,688
	<u>\$ 3,454,374</u>	<u>\$ 2,772,597</u>

(4) INVESTMENTS:

Interest and dividends for 2019 and 2018 were \$180,844 and \$118,248, respectively. Net investment gains for 2019 were \$148,377 and net investment losses for 2018 were \$7,983. Account fees for 2019 and 2018 were \$23,599 and \$14,874, respectively.

The Association invests primarily in debt instruments. The fair value of these investments will generally increase when interest rates decline and decrease when interest rates rise. As of December 31, 2019, the net unrealized gain on all investments was \$67,535. As of December 31, 2018 the net unrealized loss on all investments was \$106,680.

(4) INVESTMENTS (Continued):

The Association maintains investments in separate funds designated by the Board of Directors for different purposes.

Reserve Fund-

The Reserve Fund is maintained to finance the future repair and replacement of existing assets as outlined in the supplementary information on future major repairs and replacements on Schedule 1. The Reserve Fund is funded through member assessments, capital contribution fees, and special membership fees.

Capital Fund-

The Capital Fund is maintained to finance purchases of new assets. The Capital Fund is funded through capital contribution fees and special membership fees.

Operating Fund-

The Operating Fund is maintained to finance operations under extraordinary circumstances. The Operating Fund was funded by the proceeds from the 2015 sale of a land easement.

Investments consisted of the following at December 31:

	<u>2019</u>	<u>2018</u>
Reserve Fund:		
Cash	\$ 1,631,811	\$ 757,592
Cash equivalents	443,554	983,320
Bonds	4,441,364	2,926,851
Bond funds	<u>414,854</u>	<u>281,598</u>
Total Reserve Fund	6,931,583	4,949,361
Capital Fund:		
Cash	492,681	91,588
Cash equivalents	42,459	95,807
Bonds	425,148	285,168
Bond funds	<u>39,712</u>	<u>27,437</u>
Total Capital Fund	1,000,000	500,000
Operating Fund:		
Cash equivalents	62,726	39,688
Bond funds	489,310	461,328
Equity funds	<u>207,919</u>	<u>180,499</u>
Total Operating Fund	<u>759,955</u>	<u>681,515</u>
	<u>\$ 8,691,538</u>	<u>\$ 6,130,876</u>

(5) INVENTORIES:

Inventories consisted of the following at December 31:

	<u>2019</u>	<u>2018</u>
Golf shop merchandise	\$ 204,586	\$ 222,245
Food and beverage	194,154	145,930
Gate transponders	18,872	18,872
Utilities	<u>842</u>	<u>8,400</u>
	<u>\$ 418,454</u>	<u>\$ 395,447</u>

(6) REVOLVING LINE OF CREDIT:

The Association maintains a \$1,500,000 revolving line of credit with a bank. Outstanding borrowings are charged interest at LIBOR plus 3.00%. The member receivables, inventory, furniture, equipment, and titled vehicles are assigned as collateral. There were no outstanding borrowings at December 31, 2019 or 2018.

(7) CAPITAL LEASE OBLIGATIONS:

Property and equipment include a capitalized lease for golf course maintenance equipment that was obtained in 2019. The amount capitalized in equipment totaled \$161,885. Capital lease amortization, included in depreciation expense, totaled \$10,792 for 2019. Accumulated amortization, included in accumulated depreciation, on equipment acquired via capital lease totaled \$10,792 at December 31, 2019.

The future minimum lease payments by year required under this capital lease, together with the present value of the minimum lease payments discounted at 5.59%, as of December 31, 2019 were as follows:

Year ending December 31,	
2020	\$ 37,187
2021	37,187
2022	37,187
2022	37,187
2023	<u>21,693</u>
Total minimum lease payments	170,441
Less - amount representing interest	<u>(20,389)</u>
Total present value of minimum lease payments	150,052
Less - current portion of obligation	<u>(29,549)</u>
Non-current portion of obligation	<u>\$ 120,503</u>

In February 2020, the Association executed a capital lease for an additional \$491,435 of golf course maintenance equipment. This capital lease requires 60 monthly payments of \$9,407, which are expected to begin in May 2020.

(8) CAPITAL CONTRIBUTION FEES:

The capital contribution fee paid to the Association by each new member purchasing property within Forest Highlands was \$48,500 and \$46,200 for 2019 and 2018, respectively. Capital contribution fees totaled \$2,924,500 and \$1,702,800 in 2019 and 2018, respectively. Terminating members do not receive a refund of their capital contribution fee.

(9) SPECIAL MEMBERSHIPS:

Special memberships are available for individuals to be a member of the Association without owning property within Forest Highlands. The Board of Directors approved the sale of up to ten special memberships per year. Special memberships may be sold to the public for \$50,000 each or to a family member of an existing member or a recent previous member for \$15,000 each. There was one special membership sold in 2019 for \$50,000 and six special memberships sold in 2018 for a total of \$170,000.

(10) MEMBER ASSESSMENTS:

Monthly member assessments were as follows:

	<u>2019</u>	<u>2018</u>
Designated for operations	\$ 745	\$ 665
Designated for the reserve fund	150	150
	<u>\$ 895</u>	<u>\$ 815</u>

(11) REVENUES AND COST OF REVENUES:

Revenues includes all department related revenue from both members and nonmembers. Cost of revenues includes direct expenses. Revenues and cost of revenues for major departments consist of the following:

	<u>2019</u>	<u>2018</u>
Food and beverage:		
Revenues - food	\$ 990,714	\$ 901,920
Revenues - beverage	594,777	544,323
Revenues - catering and events	393,729	423,857
Total revenues	<u>1,979,220</u>	<u>1,870,100</u>
Cost of revenues - food and beverage	673,319	680,530
Cost of revenues - payroll	1,862,501	1,579,071
Cost of revenues - supplies	190,025	156,135
Cost of revenues - miscellaneous	419,688	432,656
Total cost of revenues	<u>3,145,533</u>	<u>2,848,392</u>
Food and beverage, net	<u>\$ (1,166,313)</u>	<u>\$ (978,292)</u>

(11) REVENUES AND COST OF REVENUES (Continued):

	<u>2019</u>	<u>2018</u>
Golf operations:		
Revenues - merchandise sales	\$ 518,283	\$ 528,554
Revenues - tournament fees	356,605	318,972
Revenues - guest fees	298,390	257,458
Revenues - golf cart rental	434,118	402,751
Revenues - miscellaneous	<u>55,639</u>	<u>48,236</u>
Total revenues	<u>1,663,035</u>	<u>1,555,971</u>
Cost of revenues - merchandise	444,523	416,482
Cost of revenues - tournaments	389,109	342,205
Cost of revenues - golf carts	195,002	207,659
Cost of revenues - payroll	919,833	869,991
Cost of revenues - miscellaneous	<u>300,742</u>	<u>287,472</u>
Total cost of revenues	<u>2,249,209</u>	<u>2,123,809</u>
Golf operations, net	<u><u>\$ (586,174)</u></u>	<u><u>\$ (567,838)</u></u>

(12) OTHER INCOME (EXPENSE):

Other income (expense), net consisted of the following for the years ended December 31:

	<u>2019</u>	<u>2018</u>
Investment income, net	\$ 211,874	\$ 108,358
Sales center lease income	149,626	130,166
Real estate taxes	(104,974)	(100,529)
Loss on disposal of property and equipment, net	(18,220)	(823,985)
Interest expense	<u>(3,661)</u>	<u>-</u>
	<u><u>\$ 234,645</u></u>	<u><u>\$ (685,990)</u></u>

(13) INCOME TAXES:

The Association is qualified as an exempt corporation under the provisions of the Internal Revenue Code Section 501(c)(7). However, as a result of the provisions of the Tax Reform Act of 1969, the Association is taxed on all net income from non-membership activities, including investment income, reduced only by losses from non-membership activities for which a profit motive exists. The Association can make certain elections for income tax purposes, which may defer the payment of income taxes. These elections include the designation of a portion of the annual dues as available only for capital expenditures and a one-year deferral of excess membership revenue. In certain years, the Association may qualify to file as a homeowner association, wherein net income from exempt activities is not subject to income taxes. Exempt revenue is revenue received from members that is not based on specific usage or goods or services received. Membership assessments are exempt revenue. Non-exempt revenue includes all other revenues, such as golf and food and beverage operations.

Management believes the tax positions taken on the Association's tax returns are fairly stated. With few exceptions, the Association is no longer subject to U.S. federal, state, and local income tax examinations by tax authorities for years before 2015.

The Association had operating losses for income tax purposes in prior years because tax deductible expenses exceeded taxable assessments and revenues during those years. Losses can be carried forward for twenty years. As of December 31, 2019, the Association had approximately \$15,200,000 and \$5,500,000, respectively, of available net operating losses to offset against future Federal and State taxable income.

(14) OPERATING LEASES:

The Association leased its golf carts under a noncancelable operating lease, which expired in 2019. Total lease expense was \$195,002 and \$207,659 for 2019 and 2018, respectively.

In February 2020, the Association executed new operating leases for golf carts, golfer GPS units, and utility and shuttle carts. Future minimum lease payments under these three new operating leases are expected to be as follows:

Year ending December 31,	
2020	\$ 205,824
2021	205,824
2022	205,824
2022	205,824
2023	205,824
Total	<u>\$ 1,029,120</u>

(14) OPERATING LEASES (Continued):

The Association is the lessor under an operating lease, which covers the sales center at Forest Highlands. The lease was renewed effective January 1, 2018 for a term of four years with base rent of \$94,500 per year and increases based on the consumer price index. The lease includes additional variable rent equal to 0.25% of annual gross home sales above \$20,000,000. Total lease income was \$149,626 and \$130,166 for 2019 and 2018, respectively. Future minimum lease payments to be received under this operating lease are as follows:

2020	\$	98,316
2021		<u>98,316</u>
Total	\$	<u><u>196,632</u></u>

(15) RETIREMENT PLAN AND TRUST:

The Association has a profit-sharing plan (the Plan) under Section 401 and 401(k) of the Internal Revenue Code. The Plan provides for retirement, disability, and accidental benefits for eligible employees. The Association matches employee contributions at a rate of 100% of the first 3% of employee contributions and 50% on the next 2% of employee contributions. The Plan also provides for additional contributions by the employer at the Board of Directors' discretion. As of December 31, 2019 and 2018, the Association's liability to the Plan for employee and matching contributions was \$12,031 and \$10,488, respectively. The Association's matching contributions to the Plan totaled \$101,214 and \$88,033 in 2019 and 2018, respectively.

(16) CONCENTRATIONS:

Financial instruments that potentially subject the Association to significant concentrations of credit risk consist principally of member receivables. Management believes the current allowance for uncollectible accounts is adequate to reduce the member receivables to net realizable value.

The Association's cash and cash equivalent balances in financial institutions exceed federally insured limits in the normal course of business. At December 31, 2019, the Association had approximately \$2,991,000 of deposits in excess of federally insured limits.

(17) FAIR VALUE OF FINANCIAL INSTRUMENTS:

The Association classifies its investments into three levels. Level 1 refers to securities traded in an active market. Level 2 refers to securities not traded in an active market but for which observable market inputs are readily available, or Level 1 securities where there is a contractual restriction. Level 3 refers to securities not traded in an active market and for which no significant observable market inputs are available.

(17) FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued):

The Association's portfolio investments were classified as follows, based on fair values:

<u>December 31, 2019</u>				
<u>Description</u>	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Cash	\$ 2,124,492	\$ 2,124,492	\$ -	\$ -
Money market funds	548,739	\$ 548,739		
Bonds	4,866,512	-	4,866,512	-
Bond funds	943,877	943,877	-	-
Equity funds	207,918	207,918	-	-
Total	<u>\$ 8,691,538</u>	<u>\$ 3,825,026</u>	<u>\$ 4,866,512</u>	<u>\$ -</u>

<u>December 31, 2018</u>				
<u>Description</u>	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Cash	\$ 849,180	\$ 849,180	\$ -	\$ -
Money market funds	1,118,815	\$ 1,118,815		
Bonds	3,212,019	-	3,212,019	-
Bond funds	770,363	770,363	-	-
Equity funds	180,499	180,499	-	-
Total	<u>\$ 6,130,876</u>	<u>\$ 2,918,857</u>	<u>\$ 3,212,019</u>	<u>\$ -</u>

(18) RECLASSIFICATIONS:

Certain reclassifications have been made to the prior year's financial statements to conform to the current year presentation. These reclassifications had no effect on previously reported results of operations or members' equity.

(19) SUBSEQUENT EVENTS:

Management has evaluated all subsequent events through the date the financial statements were available to be issued on March 25, 2020. No subsequent events occurred during this period which require adjustment to or disclosure in the financial statements, except as disclosed in note 7 and note 14.

THE FOREST HIGHLANDS ASSOCIATION AND SUBSIDIARIES
SUPPLEMENTARY INFORMATION ON
FUTURE MAJOR REPAIRS AND REPLACEMENTS (Unaudited)
DECEMBER 31, 2019

In July 2017, Reserve Data Analysis, Inc., an independent reserve analyst, completed a reserve study analysis to estimate the remaining useful lives and the replacement costs of the components of common property. The Association's governing documents require that funds be accumulated for future repairs and replacements. Accumulated funds are held in separate accounts and are not available for operating purposes.

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 Reserve Fund. The study assumed an inflation rate of 2.10% and an investment yield of 0.00%. Actual expenditures, however, will vary from the estimated amounts and the variations may be material. Therefore, amounts accumulated in the Reserve Fund may not be adequate to meet future needs. If additional funds are needed, the Association has the right, subject to member approval, to increase regular assessments above the state statute limit or levy special assessments. The Association may also delay major repairs and replacements until funds are available.

The following schedule sets forth the projected annual expenditures which will be required to maintain the property and equipment in its present condition, as reported in the July 2017 study.

THE FOREST HIGHLANDS ASSOCIATION AND SUBSIDIARIES
 SUPPLEMENTARY INFORMATION ON
 FUTURE MAJOR REPAIRS AND REPLACEMENTS (Unaudited) (Continued)
 DECEMBER 31, 2019

COMPONENTS:	GOLF COURSE	RECREATION	STREETS	CLUBHOUSE	WATER COMPANY	WASTEWATER COMPANY	OPERATIONS	TOTAL
<u>YEAR</u>								
2020	\$ 782,816	\$ 34,059	\$ 177,389	\$ 56,942	\$ 347,185	\$ 128,784	\$ 674,596	\$ 2,201,771
2021	433,043	192,343	181,114	272,573	141,486	117,470	297,490	1,635,519
2022	268,500	88,206	1,593,688	98,968	1,109,504	86,208	1,140,570	4,385,644
2023	242,986	42,480	188,801	177,421	90,851	45,992	200,506	989,037
2024	359,700	158,684	192,766	113,057	191,069	99,814	1,586,109	2,701,199
2025	455,820	46,999	196,814	653,440	450,742	157,175	860,862	2,821,852
2026	895,819	261,030	200,947	1,369,812	256,207	188,327	529,896	3,702,038
2027	190,189	105,866	205,167	215,425	1,179,789	183,542	3,976,124	6,056,102
2028	385,224	199,839	1,398,517	267,709	27,651	171,183	72,269	2,522,392
2029	402,938	151,423	213,874	68,012	152,706	73,145	3,687,142	4,749,240
2030	888,965	30,134	218,366	308,054	458,174	139,797	380,611	2,424,101
2031	434,754	358,104	1,408,735	783,333	200,923	125,343	258,263	3,569,455
2032	955,375	200,089	227,633	394,306	1,425,892	136,989	2,140,204	5,480,488
2033	282,382	65,541	232,414	170,962	44,902	95,661	338,858	1,230,720
2034	338,144	67,629	237,294	203,598	232,358	491,483	1,913,252	3,483,758
2035	430,284	113,822	242,277	142,968	647,897	391,035	164,264	2,132,547
2036	503,882	168,455	263,691	1,891,054	185,820	108,346	200,069	3,321,317
2037	308,375	196,239	2,176,654	244,156	1,449,287	451,728	338,682	5,165,121
2038	1,375,752	39,453	257,864	223,181	289,323	134,140	1,183,383	3,503,096
2039	380,700	83,723	263,279	113,736	153,228	111,525	1,028,557	2,134,748
2040	464,499	361,277	268,808	1,059,638	339,019	278,377	649,169	3,420,787
2041	571,409	293,115	274,453	307,655	273,684	309,417	863,701	2,893,434
2042	807,021	170,651	280,216	121,389	1,899,862	117,691	1,765,358	5,162,188
2043	229,166	91,838	1,910,091	160,502	26,092	115,356	352,761	2,885,806
2044	1,296,084	104,283	292,109	286,770	196,647	154,584	386,109	2,716,586
2045	638,835	63,526	298,243	288,281	717,034	110,946	565,582	2,682,447
2046	582,824	548,110	1,924,045	2,561,744	283,556	123,690	310,230	6,334,199
	<u>\$ 14,905,486</u>	<u>\$ 4,236,918</u>	<u>\$ 15,325,249</u>	<u>\$ 12,554,686</u>	<u>\$ 12,770,888</u>	<u>\$ 4,647,748</u>	<u>\$ 25,864,617</u>	
Grand Total								<u>\$ 90,305,592</u>

See accompanying independent auditors' report