



CERTIFIED PUBLIC ACCOUNTANT

BRADFORD G. BENTON

*Independent Auditor's Report*

Board of Directors  
Park Paseo Homeowners Association:

We have audited the accompanying balance sheet of Park Paseo Homeowners Association as of December 31, 2002, 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 audits.

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 above present fairly, in all material respects, the financial position of Park Paseo Homeowners Association as of December 31, 2002 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.

The supplementary information on future major repairs and replacements on page 7 is not a required part of the basic financial statements but is supplementary information required by the American Institute of Certified Public Accountants. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

A handwritten signature in cursive script that reads "Bradford G. Benton". The signature is written in black ink and is positioned above the date.

February 18, 2003

PARK PASEO HOMEOWNERS ASSOCIATION

BALANCE SHEET

DECEMBER 31, 2002

**ASSETS**

	Operating Fund	Replace- ment Fund	Total
<b>Assets</b>			
Cash and cash equivalents	\$ 97,041	\$ 4,995	\$ 102,036
Investments	173,926	387,920	561,846
Assessments receivable	7,086		7,086
Interest receivable	2,896		2,896
Prepaid income taxes	2,154	-	2,154
Total assets	<u>\$ 283,103</u>	<u>\$ 392,915</u>	<u>\$ 676,018</u>

**LIABILITIES AND FUND BALANCES**

<b>Liabilities</b>			
Accounts payable	\$ 4,578	\$ -	\$ 4,578
Prepaid assessments	4,253		4,253
Total liabilities	<u>8,831</u>	-	<u>8,831</u>
<b>Fund balance</b>			
Accumulated excess of revenues over expenses	283,845	392,915	676,760
Accumulated other comprehensive income			
Net unrealized losses on investment (Franklin Fund)	(9,573)		(9,573)
Total fund balance	<u>274,272</u>	<u>392,915</u>	<u>667,187</u>
Total liabilities and fund balance	<u>\$ 283,103</u>	<u>\$ 392,915</u>	<u>\$ 676,018</u>

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

**PARK PASEO HOMEOWNERS ASSOCIATION**

**STATEMENT OF REVENUES AND EXPENSES AND**

**CHANGES IN FUND BALANCES**

*For the year ended December 31, 2002*

	Operating Fund	Replace- ment Fund	Total
<b><u>Revenues</u></b>			
Member assessments	\$ 413,675	\$ 43,825	\$ 457,500
Interest	15,801		15,801
Late charges and lien fees	5,410		5,410
Other charges to owners	9,591		9,591
Other	7,380		7,380
Total revenues	<u>451,857</u>	<u>43,825</u>	<u>495,682</u>
<b><u>Expenses</u></b>			
Utilities	55,887		55,887
Landscape maintenance	149,607		149,607
Pool and spa	19,347	3,225	22,572
Lifeguards	19,493		19,493
Common areas	38,081	19,779	57,860
Security	43,162		43,162
Management fees	49,600		49,600
Insurance	15,397		15,397
Legal and professional	6,388		6,388
Income taxes	5,380		5,380
Print, postage, & supplies	8,792		8,792
Newsletter	3,391		3,391
Other	5,641		5,641
Total expenses	<u>420,166</u>	<u>23,004</u>	<u>443,170</u>
Excess of revenues over expenses	31,691	20,821	52,512
Beginning fund balances	<u>252,154</u>	<u>372,094</u>	<u>624,248</u>
<b>ENDING FUND BALANCES</b>	<b><u><u>\$ 283,845</u></u></b>	<b><u><u>\$ 392,915</u></u></b>	<b><u><u>\$ 676,760</u></u></b>

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

**PARK PASEO HOMEOWNERS ASSOCIATION**

**STATEMENT OF CASH FLOWS**

*For the year ended December 31, 2002*

	Operating Fund	Replace- ment Fund	Total
Excess (deficiency) of revenues over expenses	\$ 31,691	\$ 20,821	\$ 52,512
Adjustments to reconcile excess (deficiency) of revenues over expenses to net cash provided (used) by operating activities:			
(Increase)/Decrease in:			
Assessments receivable	7,489		7,489
Interest receivable	(2,896)		(2,896)
Prepaid income taxes	(2,154)		(2,154)
Increase/(Decrease) in:			
Accounts payable	(1,315)		(1,315)
Prepaid assessments	1,096		1,096
Income taxes payable	(2,099)		(2,099)
Total adjustments	121	-	121
<b>Net cash provided (used) by operating activities</b>	31,812	20,821	52,633
Cash flows from investing activities:			
Purchase of investments (CDs)	(173,926)	(138,838)	(312,764)
Net unrealized loss on investment	(1,192)		(1,192)
<b>Net increase/(decrease) in cash and cash equivalents</b>	(143,306)	(118,017)	(261,323)
Cash and cash equivalents at beginning of year	240,347	123,012	363,359
<b>Cash and cash equivalents at end of year</b>	<u>\$ 97,041</u>	<u>\$ 4,995</u>	<u>\$ 102,036</u>

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

PARK PASEO HOMEOWNERS ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

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1. Organization and Summary of Significant Accounting Policies

a) Organization

Park Paseo Homeowners Association (the Association) was organized as a nonprofit corporation in 1977 in the state of California. Its purpose is to provide management and maintenance of the common areas within the development, which is located in the city of Irvine, California. The development consists of 625 single family dwellings.

b) Fund Accounting

The Association's operations are segregated between operating funds and replacement funds. The operating fund is used to account for normal maintenance and service operations related to the common area. Disbursements from the operating fund are generally at the discretion of the Board of Directors. The replacement fund is utilized to account for the long-term major repair and replacement requirements of the Association. Disbursements from the replacement fund may be made only for their designated purpose.

c) Property and Equipment

Real property and common areas acquired from the developer and related improvements to such property are not recorded in the Association's financial statements.

d) Interest Earned

The Association's policy is to allocate to the operating fund interest earned on all replacement fund cash and investment accounts.

e) Cash and Cash Equivalents

Certificates of deposit with a maturity of three months or less at the time of purchase are considered to be cash equivalents. Those with a maturity over three months at the time of purchase are classified as investments.

f) Use of Estimates

Management uses estimates and assumptions in preparing financial statements in accordance with generally accepted accounting principles. Those estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported revenues and expenses. Actual results could vary from the estimates that were used.

g) FDIC Insurance Limits

The Association had funds in excess of the \$100,000 federally insured limit on deposit at financial institutions during the period.

PARK PASEO HOMEOWNERS ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

2. Summary of Cash and Cash Equivalents at December 31, 2002

<u>Bank</u>	<u>Interest Rate</u>	<u>Maturity Date</u>	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>Total</u>
Cash and cash equivalents consist of:					
Washington Mutual:					
Checking	0.22%		\$ 72,669	\$ -	\$ 72,669
Savings	1.04%		15,989		15,989
Wells Fargo			7,883		7,883
Petty Cash			500		500
Smith Barney:					
Money Fund	0.94%			4,995	4,995
Total cash and equivalents			<u>\$ 97,041</u>	<u>\$ 4,995</u>	<u>\$ 102,036</u>
Investments consist of the following:					
Franklin Adjustable US Govt. Securities					
Fund - at current value (a) (b)		N/A	\$ 23,926	\$ 140,449	\$ 164,375
Smith Barney CDs:					
Indust. Bank of Japan	2.70%	03/27/03	75,000		75,000
MBNA America Bank	2.50%	07/03/03	75,000		75,000
Beal Bank	2.10%	09/24/03		75,000	75,000
Provident Bank	2.00%	12/31/03		80,000	80,000
World Savings, CD	1.10%	06/13/03		92,471	92,471
Total investments			<u>\$ 173,926</u>	<u>\$ 387,920</u>	<u>\$ 561,846</u>

(a) The investment in the Franklin Adjustable U S Government Securities Fund is recorded at fair market value. The corresponding unrealized gain or loss in the fair market value in relation to cost is accounted for as a separate item in the fund balance section of the balance sheet.

(b) This is a mutual fund that invests primarily in adjustable-rate, mortgage-backed securities, or other securities collateralized by, or representing an interest in, mortgages, issued or guaranteed by the U.S. government, its agencies or instrumentalities.

3. Owners' Assessments

Monthly assessments to owners during 2002 were \$61.00. Of this amount, \$5.85 was allocated to the replacement fund during the year. At December 31, 2002 all assessments receivable were deemed to be collectible.

The annual budget and owners' assessments were determined by the Board of Directors. Currently, the Association retains excess operating funds at the end of the operating year, if any, for use in future operating periods.

PARK PASEO HOMEOWNERS ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

4. Future Major Repairs and Replacements

The Association has established a policy of assessing members monthly and accumulating funds based on current estimated replacement costs. Accumulated funds are held in separate savings accounts and are generally not available for expenditures for normal operations.

In October 2002 the Association retained an independent company, which specializes in conducting reserve studies, to estimate the remaining useful lives and the replacement costs of the components of common property. The estimates were based on current estimated replacement costs. The study concluded that the Association's funds available for reserves at December 31, 2002 were adequate. The table included in the unaudited supplementary information of Future Major Repairs and Replacements is based on the study. {PRIVATE }

The Board of Directors has included \$66,136 in the 2003 budget for reserves, which is the amount recommended by the study referred to above.

Funds are being accumulated in the replacement fund based on estimates of future needs for repairs and replacements of common property components. Actual expenditures may vary from the estimated future expenditures, and the variations may be material. Therefore, amounts accumulated in the replacement fund may not be adequate to meet all future needs for major repairs and replacements. If additional funds are needed, the Association has the right to increase regular assessments, pass special assessments, or delay major repairs and replacements until funds are available.

5. Income Taxes

Homeowners' associations may be taxed either as homeowners' associations or as regular corporations. As a regular corporation, membership income is exempt from taxation if certain elections are made, and the Association is taxed only on its nonmembership income, such as interest earnings, at regular federal and state corporate rates. Under the homeowners' association election, the Association is taxed on its nonexempt function income, such as interest earnings, at a flat rate of 30% for federal and the regular corporate rate for state. Exempt function income, which consists primarily of member assessments, is not taxable.

For the year ended December 31, 2002 the Association filed as a homeowner association.

Income taxes consist of:

	<u>Federal</u>	<u>State</u>	<u>Total</u>
Income taxes	\$ 4,111	\$ 1,269	\$ 5,380
less payments made	(4,504)	(3,030)	(7,534)
Balance due (prepaid)	<u>\$ (393)</u>	<u>\$ (1,761)</u>	<u>\$ (2,154)</u>

6. Contingency

During 2001 the Association was served with a lawsuit involving an injury which occurred in the common area. The plaintiff alleges physical and emotional injuries arising from the incident. The matter was turned over to the Association's insurance carrier for defense. The matter was settled during the year with no financial affect on the Association.

**PARK PASEO HOMEOWNERS ASSOCIATION**  
**SUPPLEMENTARY INFORMATION ON**  
**FUTURE MAJOR REPAIRS AND REPLACEMENTS**

**December 31, 2002**  
**(Unaudited)**

In October 2002, the Association retained an independent company, which specializes in conducting reserve studies, to estimate the remaining useful lives and the replacement costs of the components of common property. The estimates were based on current estimated replacement costs. Funding requirements consider an annual inflation rate of 3 percent and interest earned at 2.4 percent on amounts funded for future major repairs and replacements. The study concluded that the Association's funds available for future major repairs and replacements at December 31, 2002 were adequate.

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

Components	Remaining Useful Lives (yr)	Estimated Current Replacement Costs	Recommended Funding for 2003	Components of Fund Balance at 12/31/02
Roofs	0	\$ 4,600	\$ 238	\$ 4,648
Painting	0-4	17,400	3,767	10,870
Fencing	6-7	45,500	3,674	30,335
Parking lot	0-14	8,200	1,255	3,280
Lighting	1-19	40,100	3,303	32,070
Pool/spa & pool area	2-9	141,000	17,388	79,369
Rec area	0-16	92,600	7,212	30,506
Tennis court	0-6	35,600	3,221	31,489
Clubhouse	0-12	133,000	12,956	103,882
Irrigation	0-3	56,600	10,660	50,586
Other	1-7	5,900	488	4,824
Contingency		-	1,974	11,056
		<u>\$ 580,500</u>	<u>\$ 66,136</u>	<u>\$ 392,915</u>