



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, 2004, 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, 2004 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.

Bradford G. Benton

March 3, 2005

PARK PASEO HOMEOWNERS ASSOCIATION

BALANCE SHEET

DECEMBER 31, 2004

ASSETS

	<u>Operating Fund</u>	<u>Replace- ment Fund</u>	<u>Total</u>
<u>Assets</u>			
Cash and cash equivalents	\$ 49,249	\$ 22,714	\$ 71,963
Investments	130,005	480,049	610,054
Assessments receivable	6,643		6,643
Interest receivable	3,134		3,134
Prepaid income taxes	145		145
	<u>145</u>	<u> </u>	<u>145</u>
 Total assets	 <u>\$ 189,176</u>	 <u>\$502,763</u>	 <u>\$ 691,939</u>

LIABILITIES AND FUND BALANCES

<u>Liabilities</u>			
Accounts payable	\$ 17,031	\$ -	\$ 17,031
Prepaid assessments	11,179		11,179
Income taxes payable	63		63
Total liabilities	<u>28,273</u>	<u>-</u>	<u>28,273</u>
 <u>Fund balance</u>			
Accumulated excess of revenues over expenses	175,903	502,763	678,666
Accumulated other comprehensive income			
Net unrealized losses on investment (Franklin Fund)	(15,000)		(15,000)
Total fund balance	<u>160,903</u>	<u>502,763</u>	<u>663,666</u>
 Total liabilities and fund balance	 <u>\$ 189,176</u>	 <u>\$502,763</u>	 <u>\$ 691,939</u>

See accompanying notes to financial statements.

PARK PASEO HOMEOWNERS ASSOCIATION

STATEMENT OF REVENUES AND EXPENSES AND

CHANGES IN FUND BALANCES

For the year ended December 31, 2004

	Operating Fund	Replace- ment Fund	Total
<u>Revenues</u>			
Member assessments	\$ 386,021	\$ 71,479	\$ 457,500
Interest	13,170		13,170
Late charges and lien fees	5,000		5,000
Other charges to owners	7,071		7,071
Other	7,712		7,712
Total revenues	<u>418,974</u>	<u>71,479</u>	<u>490,453</u>
<u>Expenses</u>			
Utilities	54,868		54,868
Landscape maintenance	143,619		143,619
Pool and spa	15,818	9,193	25,011
Lifeguards	29,629		29,629
Common areas	34,345	50,173	84,518
Security	53,685		53,685
Management fees	59,170		59,170
Insurance	17,354		17,354
Legal and professional	8,465		8,465
Income taxes	4,151		4,151
Print, postage, & supplies	9,735		9,735
Newsletter	3,085		3,085
Other	12,140		12,140
Total expenses	<u>446,064</u>	<u>59,366</u>	<u>505,430</u>
Excess of revenues over expenses	(27,090)	12,113	(14,977)
Beginning fund balances	272,993	420,650	693,643
Interfund transfers	(70,000)	70,000	-
ENDING FUND BALANCES	<u><u>\$ 175,903</u></u>	<u><u>\$ 502,763</u></u>	<u><u>\$ 678,666</u></u>

See accompanying notes to financial statements.

PARK PASEO HOMEOWNERS ASSOCIATION

STATEMENT OF CASH FLOWS

For the year ended December 31, 2004

	Operating Fund	Replace- ment Fund	Total
Excess (deficiency) of revenues over expenses	\$ (27,090)	\$ 12,113	\$ (14,977)
Adjustments to reconcile excess (deficiency) of revenues over expenses to net cash provided (used) by operating activities:			
(Increase)/Decrease in:			
Assessments receivable	(2,741)		(2,741)
Interest receivable	(1,780)		(1,780)
Prepaid income taxes	1,380		1,380
Increase/(Decrease) in:			
Accounts payable	12,164		12,164
Prepaid assessments	(1,021)		(1,021)
Income taxes payable	63		63
Total adjustments	<u>8,065</u>	<u>-</u>	<u>8,065</u>
Net cash provided (used) by operating activities	(19,025)	12,113	(6,912)
Cash flows from investing activities:			
Purchase of investments (CDs)	(36,452)	(63,660)	(100,112)
Interfund transfer	(70,000)	70,000	
Net unrealized loss on investment	<u>(2,028)</u>		<u>(2,028)</u>
Net increase/(decrease) in cash and cash equivalents	(127,505)	18,453	(109,052)
Cash and cash equivalents at beginning of year	<u>176,754</u>	<u>4,261</u>	<u>181,015</u>
Cash and cash equivalents at end of year	<u>\$ 49,249</u>	<u>\$ 22,714</u>	<u>\$ 71,963</u>

See accompanying notes to financial statements.

PARK PASEO HOMEOWNERS ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

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 funds on deposit at financial institutions did not exceed the \$100,000 federally insured limit during the period.

PARK PASEO HOMEOWNERS ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

2. Summary of Cash and Cash Equivalents at December 31, 2004

<u>Bank</u>	<u>Interest Rate</u>	<u>Maturity Date</u>	<u>Operating Fund</u>	<u>Replace- ment Fund</u>	<u>Total</u>
Cash and cash equivalents consist of:					
Washington Mutual:					
Checking	0.22%		\$ 26,806	\$ -	\$ 26,806
Savings	1.04%			16,188	16,188
Wells Fargo			21,943		21,943
Petty Cash			500		500
Smith Barney:					
Money Fund	0.94%			6,526	6,526
Total cash and equivalents			<u>\$ 49,249</u>	<u>\$ 22,714</u>	<u>\$ 71,963</u>
Investments consist of the following:					
Franklin Adjustable US Govt. Securites					
Fund - at current value (a) (b)		N/A	\$ 34,326	\$ 135,049	\$ 169,375
World Savings	2.08%	06/16/04	95,679		95,679
Smith Barney CDs:					
First American	2.00%	08/22/05		90,000	90,000
Citi Bank	2.10%	11/04/05		85,000	85,000
Premier Bank	2.15%	07/22/05		40,000	40,000
First Signature	1.70%	04/28/05		40,000	40,000
Edward Jones:					
Bank of Russell County	1.70%	01/14/05		90,000	90,000
Total investments			<u>\$ 130,005</u>	<u>\$ 480,049</u>	<u>\$ 610,054</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 2004 were \$61.00. Of this amount, \$9.54 was allocated to the replacement fund during the year. At December 31, 2004 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 2004 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, 2004 were adequate. The table included in the unaudited supplementary information of Future Major Repairs and Replacements is based on the study.

The Board of Directors has included \$76,923 in the 2005 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, 2004 the Association filed as a homeowner association.

Income taxes consist of:

	<u>Federal</u>	<u>State</u>	<u>Total</u>
Income taxes	\$ 2,995	\$ 1,156	\$ 4,151
less payments made	(3,140)	(1,093)	(4,233)
Balance due (prepaid)	<u>\$ (145)</u>	<u>\$ 63</u>	<u>\$ (82)</u>

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

December 31, 2004
(Unaudited)

In October 2004, 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 2.0 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, 2004 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 2005 *	Components of Fund Balance at 12/31/04
Roofs	0	\$ 5,200	\$ 272	\$ 6,532
Painting	0-4	18,600	4,188	18,091
Fencing	6-7	48,300	3,536	27,196
Parking lot	0-14	8,800	1,408	5,213
Lighting	1-19	42,300	3,182	35,157
Pool/spa & pool area	2-9	149,100	20,326	95,017
Rec area	0-16	99,600	7,882	43,602
Tennis court	0-6	101,400	10,831	33,024
Clubhouse	0-12	140,100	13,298	143,818
Irrigation & tree trimming	0-3	63,800	13,619	61,826
Other	1-7	6,000	468	848
Contingency		-	2,451	32,439
		<u>\$ 683,200</u>	<u>\$ 81,462</u>	<u>\$ 502,763</u>

* This is the amount recommended by the study, which includes interest on amounts previously set aside for reserves.