



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, 2006, 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, 2006 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 black ink that reads "Bradford B. Benton". The signature is written in a cursive style with a long horizontal flourish extending to the right.

March 20, 2007

PARK PASEO HOMEOWNERS ASSOCIATION

BALANCE SHEET

DECEMBER 31, 2006

ASSETS

	<u>Operating Fund</u>	<u>Replace- ment Fund</u>	<u>Total</u>
<u>Assets</u>			
Cash and cash equivalents	\$ 44,826	\$ 14,359	\$ 59,185
Investments		525,996	525,996
Interest receivable	5,675		5,675
Assessments receivable	2,836		2,836
Total assets	<u>\$ 53,337</u>	<u>\$ 540,355</u>	<u>\$ 593,692</u>

LIABILITIES AND FUND BALANCES

Accounts payable	\$ 6,775	\$ -	\$ 6,775
Prepaid assessments	18,779		18,779
Income taxes payable	4,595		4,595
Total liabilities	<u>30,149</u>	<u>-</u>	<u>30,149</u>
<u>Fund balance</u>			
Accumulated excess of revenues over expenses	33,029	540,355	573,384
Accumulated other comprehensive income - net unrealized losses on investment (Franklin Fund)	<u>(9,841)</u>		<u>(9,841)</u>
Total fund balance	<u>23,188</u>	<u>540,355</u>	<u>563,543</u>
Total liabilities and fund balance	<u>\$ 53,337</u>	<u>\$ 540,355</u>	<u>\$ 593,692</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, 2006

	Operating Fund	Replace- ment Fund	Total
<u>Revenues</u>			
Member assessments	\$ 406,025	\$ 81,475	\$ 487,500
Interest	25,473		25,473
Late charges and lien fees	5,815		5,815
Other charges to owners	5,968		5,968
Other	16,967		16,967
Total revenues	<u>460,248</u>	<u>81,475</u>	<u>541,723</u>
<u>Expenses</u>			
Utilities	66,544		66,544
Landscape maintenance	140,982	44,660	185,642
Pool and spa	17,499	3,716	21,215
Lifeguards	18,059		18,059
Common areas	41,306		41,306
Security	44,752		44,752
Management fees	59,425		59,425
Insurance	17,685		17,685
Legal and professional	9,077		9,077
Income taxes	8,373		8,373
Print, postage, & supplies	10,718		10,718
Newsletter	2,988		2,988
Other	10,843		10,843
Loss on sale of investment	8,102		8,102
Clubhouse remodel	-	22,728	22,728
Total expenses	<u>456,353</u>	<u>71,104</u>	<u>527,457</u>
Excess of revenues over expenses	3,895	10,371	14,266
Beginning fund balances	29,134	529,984	559,118
ENDING FUND BALANCES	<u><u>\$ 33,029</u></u>	<u><u>\$ 540,355</u></u>	<u><u>\$ 573,384</u></u>

See accompanying notes to financial statements.

PARK PASEO HOMEOWNERS ASSOCIATION

STATEMENT OF CASH FLOWS

For the year ended December 31, 2006

	Operating Fund	Replace- ment Fund	Total
Excess (deficiency) of revenues over expenses	\$ 3,895	\$ 10,371	\$ 14,266
Adjustments to reconcile excess (deficiency) of revenues over expenses to net cash provided (used) by operating activities:			
(Increase)/Decrease in:			
Assessments receivable			-
Interest receivable	(1,939)		(1,939)
Prepaid income taxes	(2,836)		(2,836)
Increase/(Decrease) in:			
Accounts payable	1,487		1,487
Prepaid assessments	13,893		13,893
Income taxes payable	(319)		(319)
Total adjustments	<u>10,286</u>	<u>-</u>	<u>10,286</u>
Net cash provided (used) by operating activities	14,181	10,371	24,552
Cash flows from investing activities:			
Purchase of CDs	-	(103,316)	(103,316)
Sale of investment	-	80,000	80,000
Net unrealized loss on investment	7,448		7,448
Net increase/(decrease) in cash and cash equivalents	21,629	(12,945)	8,684
Cash and cash equivalents at beginning of year	<u>23,197</u>	<u>27,304</u>	<u>50,501</u>
Cash and cash equivalents at end of year	<u>\$ 44,826</u>	<u>\$ 14,359</u>	<u>\$ 59,185</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, 2006

<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			\$ 26,212	\$ 3,059	\$ 29,271
Savings	0.20%		-	5,252	5,252
Wells Fargo			18,114	-	18,114
Petty Cash			500	-	500
Smith Barney MM	4.86%		-	5,032	5,032
Edward Jones MM	4.54%		-	1,016	1,016
Total cash and equivalents			<u>\$ 44,826</u>	<u>\$ 14,359</u>	<u>\$ 59,185</u>
Investments consist of the following:					
Franklin Adjustable US Govt. Securites					
Fund - at current value (a) (b)			\$ -	\$ 99,540	\$ 99,540
World Savings	5.41%	03/12/07		103,456	103,456
Smith Barney CDs:					
Western Bank	5.15%	03/08/07		40,000	40,000
Western Bank	5.15%	02/23/07		30,000	30,000
Fremont Investment	5.10%	03/14/07		36,000	36,000
First Bank of PR	5.10%	02/23/07		40,000	40,000
Edward Jones:					
South Community	5.00%	03/07/08		65,000	65,000
First Palmetto	5.00%	09/07/07		65,000	65,000
Macatawa	4.75%	02/27/07		47,000	47,000
Total investments			<u>\$ -</u>	<u>\$ 525,996</u>	<u>\$ 525,996</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 2006 were \$65.00. Of this amount, \$10.87 was allocated to the replacement fund during the year. At December 31, 2006 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 November 2006 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, 2006 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 \$93,656 in the 2007 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, 2006 the Association filed as a homeowner association.

Income taxes consist of:

	Federal	State	Total
Income taxes	\$ 6,233	\$ 2,140	\$ 8,373
less payments made	(3,700)	(78)	(3,778)
Balance due (prepaid)	\$ 2,533	\$ 2,062	\$ 4,595

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

December 31, 2006
(Unaudited)

In November 2006, 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 3.5 percent and interest earned at 4.0 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, 2006 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
Roofs	1-4	\$ 7,800
Painting	0	28,800
Fencing	2-17	94,300
Parking lot	0-12	9,400
Lighting	2-15	45,700
Pool/spa & pool area	1-11	196,200
Rec area	0-12	71,200
Tennis court	0-7	43,600
Clubhouse	2-29	214,400
Irrigation & tree trimming	0-3	102,600
Other	0-7	84,800
		<u>\$ 898,800</u>

The study recommended a replacement fund balance of \$583,671 at December 31, 2006. The Association's balance of reserves at December 31, 2006 is \$540,355. The study also recommended that \$93,656 be contributed to the fund during 2007. The Association's budget for 2007 provides for a reserve contribution of \$93,656.