



NOTICE

DATE: May 20, 2013

TO: Park Paseo Homeowners Association
Membership

FROM: Park Paseo Homeowners Association
Board of Directors

RE: 2012 Audit

Enclosed please find the audit for the Park Paseo Homeowners Association fiscal year ending December 31, 2012. The independent accounting firm of Inouye, Shively, Longtin & Klatt has prepared the audit for your review.

Please keep this information with your other important Association documents. Thank you.



Member:
American Institute
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To the Board of Directors of
Park Paseo Homeowners Association

INDEPENDENT AUDITOR'S REPORT

Report on the Financial Statements

We have audited the accompanying financial statements of Park Paseo Homeowners Association, which comprise the balance sheet as of December 31, 2012, and the related statements of revenues, expenses, and changes in fund balance, and cash flows for the year 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 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.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. 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 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.

Board of Directors
Park Paseo Homeowners Association

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, 2012, 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.

Emphasis of Matter

Our audit was 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 audit. 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 supplementary information on future major repairs and replacements on page 9 be presented to supplement the basic financial statements. Such information, although not 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 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.

Inouye, Shively, Longtin & Klatt

Inouye, Shively, Longtin & Klatt

Laguna Hills, CA
May 13, 2013

PARK PASEO HOMEOWNERS ASSOCIATION
BALANCE SHEET
AS OF DECEMBER 31, 2012

	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>Total</u>
Assets			
Cash and cash equivalents	\$ 133,189	\$ 671,100	\$ 804,289
Investments	-	111,000	111,000
Assessments receivable	8,930	-	8,930
Allowance for doubtful accounts	(3,849)	-	(3,849)
Accrued interest receivable	-	330	330
Prepaid expenses	75	363	438
Interfund account	(8,089)	8,089	-
Total assets	<u>130,256</u>	<u>790,882</u>	<u>921,138</u>
Liabilities			
Accounts payable	13,573	-	13,573
Prepaid assessments	12,150	-	12,150
Refundable deposits	250	-	250
Income taxes payable	10	-	10
	<u>25,983</u>	<u>-</u>	<u>25,983</u>
Fund balances	<u>104,273</u>	<u>790,882</u>	<u>895,155</u>
Total liabilities and fund balances	<u>\$ 130,256</u>	<u>\$ 790,882</u>	<u>\$ 921,138</u>

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

PARK PASEO HOMEOWNERS ASSOCIATION
STATEMENT OF REVENUES, EXPENSES,
AND CHANGES IN FUND BALANCES
FOR THE YEAR ENDED DECEMBER 31, 2012

	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>Total</u>
Revenues			
Member assessments	\$ 484,800	\$ 152,700	\$ 637,500
Interest income	-	2,470	2,470
Clubhouse rental	8,875	-	8,875
Other income	7,183	-	7,183
Total revenues	500,858	155,170	656,028
Expenses			
Landscape services	137,827	-	137,827
Pool/spa services	33,838	5,400	39,238
General maintenance and repairs	16,949	9,120	26,069
Security/patrol services	36,608	-	36,608
Pest control	1,209	-	1,209
Janitorial services	12,168	-	12,168
Water	28,179	-	28,179
Electricity	26,803	-	26,803
Gas	9,075	-	9,075
Telephone	3,702	-	3,702
Refuse	1,499	-	1,499
Management fees	60,000	-	60,000
Office supplies/printing/postage	15,725	-	15,725
Insurance	15,633	-	15,633
Legal and collection	3,269	-	3,269
Audit and tax preparation	1,750	-	1,750
Reserve study	1,600	-	1,600
General and administrative	22,717	-	22,717
Provision for doubtful accounts	3,849	-	3,849
Streets/drives	-	2,335	2,335
Clubhouse	-	3,238	3,238
Income tax	-	747	747
Total expenses	432,400	20,840	453,240
Excess of revenues over expenses	68,458	134,330	202,788
Beginning fund balances	35,652	656,715	692,367
Interfund transfer	163	(163)	-
Ending fund balances	\$ 104,273	\$ 790,882	\$ 895,155

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

PARK PASEO HOMEOWNERS ASSOCIATION
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2012

	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>Total</u>
Cash flows from operating activities:			
Excess of revenues over expenses	\$ 68,458	\$ 134,330	\$ 202,788
Adjustments to reconcile excess of revenues over expenses to net cash provided by operating activities			
Decrease in net assessments receivable	5,037	-	5,037
Decrease in accrued interest receivable	-	329	329
Decrease (increase) in prepaid expenses	15,074	(363)	14,711
Decrease in accounts payable	(2,688)	-	(2,688)
Increase in prepaid assessments	1,040	-	1,040
Increase in refundable deposits	250	-	250
Decrease in income tax payable	(363)	-	(363)
Total adjustments	<u>18,350</u>	<u>(34)</u>	<u>18,316</u>
Net cash provided by operating activities	86,808	134,296	221,104
Cash flows from investing activities:			
Disposition of investments	-	237,528	237,528
Net cash provided by investing activities	-	237,528	237,528
Cash flows from financing activities:			
Change in interfund payable balances	(87,502)	87,502	-
Interfund transfer	163	(163)	-
Net cash provided by (used in) financing activities	<u>(87,339)</u>	<u>87,339</u>	<u>-</u>
Net increase (decrease) in cash and cash equivalents	(531)	459,163	458,632
Cash and cash equivalents at beginning of year	133,720	211,937	345,657
Cash and cash equivalents at end of year	<u>\$ 133,189</u>	<u>\$ 671,100</u>	<u>\$ 804,289</u>
Supplemental disclosures			
Income taxes paid	<u>\$ 200</u>	<u>\$ 1,273</u>	<u>\$ 1,473</u>

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

PARK PASEO HOMEOWNERS ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012

NOTE 1 - ORGANIZATION

Park Paseo Homeowners Association ("Association") is a nonprofit mutual benefit corporation organized for the purposes of maintaining and preserving common property of the Park Paseo community. The Association consists of 625 residential units occupying a site in Irvine, California. The Association was incorporated on June 9, 1977.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

- (a) Principles of Accounting: The books and records for the Association are maintained on a modified accrual basis of accounting. For these audited financial statements, adjustments have been made at the year-end to convert the Association's records to the full accrual basis of accounting. The tax returns are also reported on the accrual basis of accounting.
- (b) Funds: The Association uses fund accounting which requires that funds, such as operating funds and funds designated for future major repairs and replacements, be classified separately for accounting and reporting purposes. Disbursements from the operating fund are generally at the discretion of the Board of Directors and property manager. Disbursements from the replacement fund generally may be made only for their designated purposes.
- (c) Recognition of assets and depreciation policy: Real property contributed to the Association by the developer has not been recorded for financial statement purposes since the Association's governing documents impose severe limitations on its disposition. The Association recognizes personal property assets at cost. The property is depreciated over its estimated useful life using the straight line method of depreciation.
- (d) Cash equivalents and investments: Cash equivalents consist primarily of certificates of deposit and other securities with original maturities of 90 days or less. Certificates of deposit and other securities with original maturities over 90 days are classified as investments. Cash equivalents and investments are stated at cost.
- (e) Interest earned: The Board's policy is to allocate to the replacement fund interest earned on all replacement fund cash accounts.
- (f) Estimates: The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

NOTE 3 - OWNERS' ASSESSMENTS

During the year ended December 31, 2012, assessments to owners were \$637,500 of which \$152,700 was designated to the replacement fund. The annual budget and owners' assessments are determined by the Board of Directors. 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 - CONTINUED
DECEMBER 31, 2012

NOTE 4 - FUTURE MAJOR REPAIRS AND REPLACEMENTS

The Association's governing documents require that funds be accumulated for future major repairs and replacements. Substantially all accumulated funds are held in separate savings or investment accounts and are generally not available for expenditures for normal operations.

A study was conducted on September 13, 2012, by Reserve Data Analysis 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 2.7%, scheduled annual funding increase of 2.7%, and interest at 1% net of taxes of 30%, on amounts funded for future major repairs and replacements.

The table included in the unaudited supplementary information on Future Major Repairs and Replacements is based on the study.

The Board of Directors is funding for major repairs and replacements over the remaining useful lives of the components based on the study's estimates of current replacement costs and considering amounts previously accumulated in the replacement fund. Accordingly, \$136,311, an amount greater than the study's recommended funding requirement of \$134,055, has been included in the Association's 2013 budget. The study recommends an ideal cash balance in the amount of \$768,787. As of December 31, 2012, the actual available replacement fund cash balance was \$782,430.

Funds are being accumulated in the replacement fund based on estimated future costs for repairs and replacements of common property components. Actual expenditures may vary from the estimated amounts 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.

As of December 31, 2012, the operating fund owed the replacement fund \$8,089.

NOTE 5 - FEDERAL AND STATE TAXES

The Association qualifies as a tax-exempt homeowners association under Internal Revenue Code Section 528 for the year ended December 31, 2012. Under that Section, the Association is not taxed on income and expenses related to its exempt purpose, which is the acquisition, construction, management, maintenance, and care of Association property. Net nonexempt function income, which includes earned interest and revenues received from nonmembers, is taxed at 30% by the federal government and at 8.84% by the State of California.

The Association recognizes tax benefits only to the extent that it believes it is "more likely than not" that its tax positions will be sustained upon examination by taxing authorities. The Association has not been examined by taxing authorities. However, the Association's tax returns for fiscal year end 2009, 2010, 2011, and 2012 may be subject to examination by taxing authorities, generally for three years after they are filed. Management believes that all of its tax positions will be sustained if examined by taxing authorities, therefore no additional tax liabilities or related penalties and interest due to uncertain tax positions have been recorded.

PARK PASEO HOMEOWNERS ASSOCIATION
NOTES TO FINANCIAL STATEMENTS - CONTINUED
DECEMBER 31, 2012

NOTE 6 - ASSESSMENTS RECEIVABLE

As of December 31, 2012, the Association had delinquent assessments receivable of \$8,930. The Association's Declaration provides for various collection remedies for delinquent assessments including the filing of liens, foreclosing on the unit owner, and obtaining judgment on other assets of the unit owner. Delinquent assessments may be secured by a lien on the property against which assessments are made and the Association has the power to foreclose the property of any owner who fails to pay assessments.

It is the opinion of the Association that the allowance for doubtful accounts of \$3,849 is adequate to cover any accounts that may eventually be uncollectible. The allowance was computed by adding all receivable amounts in the 90 day category.

The Association writes off receivable balances once all collection alternatives have been exhausted.

NOTE 7 - INVESTMENTS

The Association's investments consist of certificates of deposit with original maturities over 90 days. The investments are considered to be held to maturity which range from March 2013 to December 2013. Investment income is recorded as it is earned. The investments are carried at cost.

NOTE 8 - SUBSEQUENT EVENTS

The Association has evaluated subsequent events and transactions for potential recognition or disclosure in the financial statements through May 13, 2013, the date the financial statements were available to be issued.

PARK PASEO HOMEOWNERS ASSOCIATION
SUPPLEMENTARY INFORMATION ON FUTURE MAJOR
REPAIRS AND REPLACEMENT
AS OF DECEMBER 31, 2012
(UNAUDITED)

A study was conducted on September 13, 2012, by Reserve Data Analysis 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. Replacement costs and useful lives can be found in published manuals such as construction estimators, appraisal handbooks, and valuation guides. Remaining lives are calculated from the useful lives and ages of assets, and adjusted according to conditions such as design, manufacture quality, usage, exposure to the elements and maintenance history. Funding requirements consider an annual inflation rate of 2.7%, scheduled annual funding increase of 2.7%, and interest at 1% net of taxes of 30%, on amounts funded for future major repairs and replacements. The study recommends an annual funding amount of \$134,055, although \$136,311 has been included in the 2013 budget. The ideal cash replacement fund balance was \$768,787, per the reserve study. As of December 31, 2012, the actual available replacement fund cash balance was \$782,430.

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

Components	Estimated Remaining Useful Lives (Years)	Estimated Current Replacement Costs
Parking lot	2-5	\$ 16,524
Roofs	10-48	37,791
Painting	1-22	36,153
Fencing	18-27	195,124
Lighting	0-9	130,282
Pools	0-14	306,819
Clubhouse	0-24	304,938
Tennis court	0-13	65,780
Rec area	0-14	108,803
Trellis	1-28	58,195
Signs	0-1	4,150
Landscape	0-3	39,000
Irrigation	0	71,791
Termite control	0	4,889
Total		<u>\$ 1,380,239</u>