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INDEPENDENT AUDITOR'S REPORT

The Board of Directors and Members
The Glen of Pacific Grove Homeowners Association

We have audited the accompanying balance sheet of The Glen of Pacific Grove Homeowners Association as of August 31, 1999 and the related statements of revenue 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 audit.

We conducted our audit in accordance with generally accepted auditing standards. 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 The Glen of Pacific Grove Homeowners Association at August 31, 1999, and the results of its operations and its cash flows for the year then ended in conformity with generally accepted accounting principles.

The Supplementary Information on Future Major Repairs and Replacements that accompanies the financial statements 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.

Allen & Cook, Inc.

October 4, 1999

THE GLEN OF PACIFIC GROVE HOMEOWNERS ASSOCIATION
BALANCE SHEET
August 31, 1999

	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>Total Funds</u>
ASSETS:			
Cash & cash equivalents	\$ 15,940	75,709	91,649
Accounts receivable, members	304		304
Due from operating fund		18,917	18,917
Prepaid insurance	10,488		10,488
Prepaid income tax	257		257
	<u>26,989</u>	<u>94,626</u>	<u>121,615</u>
Total assets	\$ <u>26,989</u>	<u>94,626</u>	<u>121,615</u>
 LIABILITIES AND FUND BALANCES:			
Accounts payable	\$ 3,667		3,667
Assessments received in advance	5,188		5,188
Due to replacement fund	18,917		18,917
Other liabilities	331		331
	<u>28,103</u>		<u>28,103</u>
Total liabilities	28,103		28,103
Fund balances	<u>(1,114)</u>	<u>94,626</u>	<u>93,512</u>
Total liabilities and fund balances	\$ <u>26,989</u>	<u>94,626</u>	<u>121,615</u>

SEE NOTES TO FINANCIAL STATEMENTS

THE GLEN OF PACIFIC GROVE HOMEOWNERS ASSOCIATION
STATEMENT OF REVENUE AND EXPENSES AND CHANGES IN FUND BALANCES
Year Ended August 31, 1999

	Operating Fund	Replacement Fund	Total Funds
REVENUE:			
Regular assessments (Note B)	\$ 99,816	44,184	144,000
Interest income (Note A3)	2,197		2,197
Other income	86		86
	<hr/>	<hr/>	<hr/>
Total revenue	102,099	44,184	146,283
	<hr/>	<hr/>	<hr/>
EXPENSES:			
Management	9,463		9,463
Insurance	22,109		22,109
Legal and accounting	5,495		5,495
Other administrative expenses	2,414		2,414
Gas and electricity	2,876		2,876
Water and sewer	5,866		5,866
Landscape maintenance	35,826		35,826
Painting		20,130	20,130
Pest control	4,485		4,485
Irrigation repair	1,439		1,439
Security	314		314
Streets		12,475	12,475
Other common area repair	4,318	300	4,618
Income taxes (Note D)	349		349
	<hr/>	<hr/>	<hr/>
Total expenses	94,954	32,905	127,859
	<hr/>	<hr/>	<hr/>
Excess (deficiency) of revenue over expenses	7,145	11,279	18,424
Beginning fund balances	<hr/> (8,259)	<hr/> 83,347	<hr/> 75,088
Ending fund balances	\$ <hr/> (1,114)	<hr/> 94,626	<hr/> 93,512

SEE NOTES TO FINANCIAL STATEMENTS

THE GLEN OF PACIFIC GROVE HOMEOWNERS ASSOCIATION
STATEMENT OF CASH FLOWS
Year Ended August 31, 1999

	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>Total Funds</u>
CASH FLOWS FROM OPERATING ACTIVITIES:			
Excess (deficiency) of revenue over expenses	\$ 7,145	11,279	18,424
Adjustments to reconcile net income to net cash provided by operating activities:			
(Increase) decrease in:			
Accounts receivable	(269)		(269)
Interfund receivable		(3,860)	(3,860)
Prepaid insurance	(524)		(524)
Prepaid income tax	425		425
Increase (decrease) in:			
Accounts payable	(3,583)		(3,583)
Assessments paid in advance	1,794		1,794
Interfund payable	3,860		3,860
Other liabilities	67		67
Net cash flows from operating activities	<u>8,915</u>	<u>7,419</u>	<u>16,334</u>
CASH FLOWS FROM INVESTING ACTIVITIES:			
Proceeds from maturing certificates of deposit		<u>50,206</u>	<u>50,206</u>
Net cash flows from investing activities		<u>50,206</u>	<u>50,206</u>
Net increase in cash	8,915	57,625	66,540
Cash at beginning of year	<u>7,025</u>	<u>18,084</u>	<u>25,109</u>
Cash at end of year	<u>\$ 15,940</u>	<u>75,709</u>	<u>91,649</u>

SEE NOTES TO FINANCIAL STATEMENTS

THE GLEN OF PACIFIC GROVE HOMEOWNERS ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
August 31, 1999

(A) - ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

(1) Organization

The Association was incorporated June 28, 1982 to provide for the orderly maintenance, preservation, and architectural control of the common areas within the development, which consists of 60 units in a planned development located in the City of Pacific Grove, California.

The Association derives its authority and responsibilities from its Declaration of Covenants, Conditions and Restrictions. An elected Board of Directors makes most policy decisions and oversees daily operations, but major decisions are referred to the general association membership if required by the governing documents.

Membership in the Association is mandatory for homeowners. Voting members consist of all owners. Each owner is obligated to pay annual assessments to the Association to support its operations and purposes.

(2) Funds

Since the Association is a not-for-profit organization, the accompanying financial statements have been prepared using a fund method of accounting. Under this method of accounting, funds are separated into two categories, operating funds and replacement funds. Operating funds are those whose disposition is at the discretion of the Board of Directors and are generally used for regular operating expenses. Replacement funds are those funds that have been limited to specific purposes by the membership or the Board of Directors.

(3) Interest Earned

It is the policy of the Board of Directors that interest earned on restricted savings is not restricted and is transferred to the operating fund when earned.

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THE GLEN OF PACIFIC GROVE HOMEOWNERS ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
August 31, 1999

(A) - ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES-Continued

(4) Capitalization Policy and Depreciation

The Association has not capitalized in the financial statements the common area real property acquired at its inception from the developer. This policy of noncapitalization is widely followed in the homeowners association industry as all beneficial rights of ownership belong to the unit owners and not to the Association.

Replacements and improvements to the real property are not capitalized for the same reasons described above. They are instead charged directly to either operating or restricted funds in the period they are incurred.

(5) Statement of Cash Flow Information

For purposes of the Statement of Cash Flows, the Association considers all short-term investments with a maturity at date of purchase of three months or less to be cash equivalents.

(6) Assessments Receivable

Association members are subject to monthly assessments to provide funds for the Association's operating expenses, future capital acquisitions, and major repairs and replacements. Assessments receivable at the balance sheet date represent fees due from unit owners. 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.

(7) Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent 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 those estimates.

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THE GLEN OF PACIFIC GROVE HOMEOWNERS ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
August 31, 1999

(B) - REGULAR ASSESSMENTS

During the fiscal year ended August 31, 1999, regular annual assessments were payable to the Association in monthly installments of \$200 per unit per month.

The annual budget and owners' assessments are determined by the Board of Directors and the homeowners. Annual budgets are approved and assessments are divided between the operating fund to meet normal operating costs and contributions to the replacement funding program.

Delinquent assessments may be secured by a lien on the property against which the assessments are made, and the Association has the power to foreclose the property of any owner who fails to pay assessments.

It is the Association policy that any excess operating funds at the end of a fiscal year be applied to the following year's assessment.

(C) - RESTRICTED FUNDS AND REPLACEMENT FUNDING PROGRAM

Restricted funds represent amounts designated for specific uses by the membership or Board of Directors; generally these funds are set aside in interest bearing accounts to be retained for the designated purpose. Restricted replacement funds are amounts to be spent on future repair and replacement of selected Association common areas.

A long-term, formal funding program is one that is based on a study that identifies specific common area components such as roofs, streets, paint, decks, etc., the expected replacement costs and expected remaining service lives of each, and provides a plan for accumulating over time the funds that will be needed to replace each major item at the time that replacement becomes necessary.

A formal study to determine the adequacy of the current funding program for the replacement of selected Association common areas was conducted by Construction Management Associates in 1997 and was updated by Sunstone Consulting, Inc. in June, 1999.

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THE GLEN OF PACIFIC GROVE HOMEOWNERS ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
August 31, 1999

(C) - RESTRICTED FUNDS AND REPLACEMENT FUNDING PROGRAM-Continued

The 1999/2000 annual budget, which was approved by the Board of Directors on June 22, 1999, incorporates the reserve funding requirements determined by the study.

However, 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 future needs. If additional funds are needed, however, the Association has the right, subject to member approval, to increase regular assessments or levy special assessments, or it may delay major repairs and replacements until funds are available.

(D) - INCOME TAXES

Homeowners' associations may be taxed either as homeowners' associations or as regular corporations. For the year ended August 31, 1999, the Association was taxed as a regular corporation. 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.

Income tax expense at August 31, 1999 was \$349. During the year ending August 31, 1999, the Association paid \$278 in cash for income taxes.

(E) - LAWSUIT

On May 21, 1999, the Association filed a lawsuit against a painting company for alleged defects in the painting work performed by the company. The lawsuit is in the early discovery stage and the amount of recovery, if any, can not be determined at this time.

THE GLEN OF PACIFIC GROVE HOMEOWNERS ASSOCIATION
 SUPPLEMENTARY INFORMATION ON FUTURE MAJOR REPAIRS
 AND REPLACEMENTS

August 31, 1999
 (UNAUDITED)

Construction Management Associates conducted a study in 1997 and was updated by Sunstone Consulting, Inc. in June, 1999 to estimate the remaining useful lives and the replacement costs of the components of common property. The estimates were based on future replacement costs at the date of the study. Estimated current replacement costs have been adjusted to reflect a 3% inflation factor between the date of the study and the date that the components will require repair and replacement.

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

<u>Components</u>	<u>Estimated Remaining Useful Lives</u>	<u>Estimated Current Replacement Costs</u>
Roofs and Gutters	14 yrs.	\$ 443,462
Painting	2 yrs.	84,026
Asphalt Driveways	4-9 yrs.	55,104
Siding and Trim	2-20 yrs.	546,753
Concrete	2-45 yrs.	159,389
Fencing	2-20 yrs.	28,508
Area Lighting	3-9 yrs.	17,700
Irrigation System	0-9 yrs.	10,000
Miscellaneous Items	0-19 yrs.	31,750
Lake Pumps	N/A	<u>30,000</u>
 Total		 <u>\$1,406,692</u>

The Association uses the cash flow method of funding the replacement fund. Under the cash flow method, the funding for each individual component is not separately calculated. The actual fund balance at August 31, 1999, is \$94,626 with expected contributions of \$44,179 for the year ending August 31, 2000.