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INDEPENDENT AUDITOR'S REPORT

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

I have audited the accompanying balance sheet of The Glen of Pacific Grove Homeowners Association as of August 31, 2004 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. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that I 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. I believe that my audit provides a reasonable basis for my opinion.

In my 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, 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 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. I have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, I did not audit the information and express no opinion on it.



December 7, 2004

THE GLEN OF PACIFIC GROVE HOMEOWNERS ASSOCIATION
BALANCE SHEET
 August 31, 2004

	Operating Fund	Replacement Fund	Total Funds
ASSETS:			
Cash & cash equivalents	\$ 22,510	184,865	207,375
Accounts receivable, members	1,420		1,420
Investment in certificates of deposit		98,037	98,037
Due from operating fund		23,852	23,852
Prepaid insurance	6,451		6,451
Prepaid income tax	95		95
	<u> </u>	<u> </u>	<u> </u>
Total assets	<u>\$ 30,476</u>	<u>306,754</u>	<u>337,230</u>
 LIABILITIES AND FUND BALANCES:			
Accounts payable	\$ 7,118		7,118
Assessments received in advance	7,596		7,596
Due to replacement fund	23,852		23,852
	<u> </u>	<u> </u>	<u> </u>
Total liabilities	38,566	0	38,566
Fund balances	<u>(8,090)</u>	<u>306,754</u>	<u>298,664</u>
Total liabilities and fund balances	<u>\$ 30,476</u>	<u>306,754</u>	<u>337,230</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, 2004

	Operating Fund	Replacement Fund	Total Funds
	<u> </u>	<u> </u>	<u> </u>
REVENUE:			
Regular assessments	\$ 117,828	58,572	176,400
Special assessments	1,980		1,980
Interest income	3,027		3,027
Other income	539		539
	<u> </u>	<u> </u>	<u> </u>
Total revenue	<u>123,374</u>	<u>58,572</u>	<u>181,946</u>
EXPENSES:			
Management & bookkeeping	8,510		8,510
Insurance	29,052		29,052
Legal and accounting	2,606		2,606
Other administrative expenses	4,378		4,378
Gas and electricity	3,030		3,030
Water and sewer	7,846		7,846
Landscape maintenance	49,217		49,217
Lakes & waterways	1,160		1,160
Irrigation repair	298		298
Pest control	2,965		2,965
Roof repair	1,491	3,758	5,249
Security	442		442
Electrical & plumbing	501		501
Bay windows		6,706	6,706
Other common area repair	8,865	28,055	36,920
Income taxes	550		550
	<u> </u>	<u> </u>	<u> </u>
Total expenses	<u>120,911</u>	<u>38,519</u>	<u>159,430</u>
Excess of revenue over expenses	2,463	20,053	22,516
Beginning fund balances	(34,143)	310,291	276,148
Other changes in fund balances:			
Interfund transfer	<u>23,590</u>	<u>(23,590)</u>	<u> </u>
Ending fund balances	<u>\$ (8,090)</u>	<u>306,754</u>	<u>298,664</u>

SEE NOTES TO FINANCIAL STATEMENTS

THE GLEN OF PACIFIC GROVE HOMEOWNERS ASSOCIATION
STATEMENT OF CASH FLOWS
Year Ended August 31, 2004

	<u>Operating Fund</u>	<u>Replacement Fund</u>	<u>Total Funds</u>
CASH FLOWS FROM OPERATING ACTIVITIES:			
Excess of revenue over expenses	\$ 2,463	20,053	22,516
Adjustments to reconcile net income to net cash provided by operating activities:			
Interfund transfer	23,590	(23,590)	
(Increase) decrease in:			
Accounts receivable	(852)		(852)
Prepaid insurance	3,833		3,833
Prepaid income tax	465		465
Due from operating fund		8,561	8,561
Increase (decrease) in:			
Accounts payable	(770)		(770)
Assessments paid in advance	1,711		1,711
Due to replacement fund	<u>(8,561)</u>		<u>(8,561)</u>
Net cash flows provided by operating activities	<u>21,879</u>	<u>5,024</u>	<u>26,903</u>
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchase of certificates of deposit		(1,673)	(1,673)
Proceeds from maturing of certificates of deposit		<u>109,272</u>	<u>109,272</u>
Net cash flows provided by investing activities	<u>0</u>	<u>107,599</u>	<u>107,599</u>
Net increase in cash	21,879	112,623	134,502
Cash at beginning of year	<u>631</u>	<u>72,242</u>	<u>72,873</u>
Cash at end of year	<u>\$ 22,510</u>	<u>184,865</u>	<u>207,375</u>

SEE NOTES TO FINANCIAL STATEMENTS

THE GLEN OF PACIFIC GROVE HOMEOWNERS ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
August 31, 2004

(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.

(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 non-capitalization is widely followed in the homeowners association industry as all beneficial rights of ownership belong to the unit owners and not to the Association.

(CONTINUED)

THE GLEN OF PACIFIC GROVE HOMEOWNERS ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
August 31, 2004

(A) - ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES-Continued

(4) Capitalization Policy and Depreciation

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.

(B) - REGULAR ASSESSMENTS

During the fiscal year ended August 31, 2004, regular annual assessments were payable to the Association in monthly installments of \$245 per unit per month.

(CONTINUED)

THE GLEN OF PACIFIC GROVE HOMEOWNERS ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
August 31, 2004

(B) - REGULAR ASSESSMENTS-Continued

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 Sunstone Consulting, Inc. in July 2001. The 2004/2005 annual budget, which was approved by the Board of Directors in July 2004, does not provide for sufficient contributions to catch up the under funded amount by August 31, 2005. Consequently, the replacement fund is estimated to be under funded by approximately \$176,894 (\$2,948 per unit) by August 31, 2005. Accordingly, it is expected that higher regular assessments or special assessments may be necessary in the future.

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THE GLEN OF PACIFIC GROVE HOMEOWNERS ASSOCIATION
NOTES TO FINANCIAL STATEMENTS
August 31, 2004

(D) - INCOME TAXES

Homeowners' associations may be taxed either as homeowners' associations or as regular corporations. For the year ended August 31, 2004, 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 non-membership income, such as interest earnings, at regular federal and state corporate rates.

Income tax expense at August 31, 2004 was \$550. During the year ending August 31, 2004, the Association paid \$85 in cash for income taxes.

(E) - CONTINGENCY

As more fully described in note C to the financial statements, the Association's funding program may not be adequate to meet all replacement needs as they come due, and this could result in higher regular assessments or special assessments in the future.

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

August 31, 2004
 (UNAUDITED)

Sunstone Consulting, Inc. conducted a study in July 2001 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 5% 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>
Roof	3 yrs.	\$ 390,807
Gutters & downspouts	2-5 yrs	76,975
Asphalt driveways	2 yrs.	45,023
Tennis / sports court	2-9 yrs.	8,071
Siding / trim	5 yrs.	170,000
Water heaters	3-13 yrs.	45,000
Fence / bridge	2-18 yrs.	66,680
Area lighting	2 yrs.	7,200
Landscape / irrigation	1-4 yrs.	8,000
Gates	3-12 yrs.	<u>20,000</u>
Total		<u>\$ 837,756</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, 2004, is \$306,754 with expected contributions of \$74,480 for the year ending August 31, 2005.