

---

# Amrik Chand, CPA

959 Corporate Way • Fremont, CA 94539 • Ph. (510) 490-8200 • Fax (510) 490-8202  
e-mail: [achand@pacbell.net](mailto:achand@pacbell.net)

## 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, 2005 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, 2005, 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 28, 2005

**THE GLEN OF PACIFIC GROVE HOMEOWNERS ASSOCIATION**  
**BALANCE SHEET**  
 August 31, 2005

	Operating Fund	Replacement Fund	Total Funds
<b>ASSETS:</b>			
Cash & cash equivalents	\$ 30,075		95,932
Accounts receivable, members	569	65,857	569
Investment in certificates of deposit		176,640	176,640
Due from operating fund		12,813	12,813
Interest receivable		855	855
Prepaid insurance	4,780		4,780
<b>Total assets</b>	<b>\$ 35,424</b>	<b>256,165</b>	<b>291,589</b>

	\$	4,200	18,770
<b>LIABILITIES AND FUND BALANCES:</b>			
Accounts payable	14,570	4,200	18,770
Assessments received in advance	9,424		9,424
Income tax payable	177		177
Due to replacement fund	12,813		12,813
<b>Total liabilities</b>	36,984	4,200	41,184
<b>Fund balances</b>	<b>(1,560)</b>	<b>251,965</b>	<b>250,405</b>
<b>Total liabilities and fund balances</b>	<b>\$ 35,424</b>	<b>256,165</b>	<b>291,589</b>

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, 2005

	Operating Fund	Replacement Fund	Total Funds
<b>REVENUE:</b>			
Regular assessments	\$ 133,380	86,940	220,320
Interest income	2,612	1,440	4,052
Other income	10		10
Total revenue	<u>136,002</u>	<u>88,380</u>	<u>224,382</u>
<b>EXPENSES:</b>			
Management & bookkeeping	8,240		8,240
Insurance	29,711		29,711
Legal and accounting	6,992		6,992
Other administrative expenses	5,147		5,147
Gas and electricity	2,842		2,842
Water and sewer	6,934		6,934
Landscape maintenance	46,487		46,487
Lakes & waterways	2,821	4,200	7,021
Irrigation repair	61		61
Pest control	4,049		4,049
Roof repair	1,551		1,551
Security	380		380
Painting		138,969	138,969
Other common area repair	13,475		13,475
Income taxes	782		782
Total expenses	<u>129,472</u>	<u>143,169</u>	<u>272,641</u>
<b>Excess (deficiency) of revenue over expenses</b>	6,530	(54,789)	(48,259)
<b>Beginning fund balances</b>	<u>(8,090)</u>	<u>306,754</u>	<u>298,664</u>
<b>Ending fund balances</b>	<u>\$ (1,560)</u>	<u>251,965</u>	<u>250,405</u>

SEE NOTES TO FINANCIAL STATEMENTS

**THE GLEN OF PACIFIC GROVE HOMEOWNERS ASSOCIATION**  
**STATEMENT OF CASH FLOWS**  
Year Ended August 31, 2005

	Operating Fund	Replacement Fund	Total Funds
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Excess (deficiency) of revenue over expenses	\$ 6,530	(54,789)	(48,259)

Adjustments to reconcile net income to net cash provided by operating activities:

(Increase) decrease in:			
Accounts receivable	851		851
Interest receivable		(855)	(855)
Prepaid insurance	1,671		1,671
Prepaid income tax	95		95
Due from operating fund		11,039	11,039
Increase (decrease) in:			
Accounts payable	7,452	4,200	11,652
Assessments paid in advance	1,828		1,828
Income tax payable	177		177
Due to replacement fund	(11,039)		(11,039)

Net cash flows provided (used) by operating activities

	7,565	(40,405)	(32,840)
--	-------	----------	----------

**CASH FLOWS FROM INVESTING ACTIVITIES:**

Purchase of certificates of deposit

		(78,603)	(78,603)
--	--	----------	----------

Net cash flows used by investing activities

	0	(78,603)	(78,603)
--	---	----------	----------

Net increase (decrease) in cash

	7,565	(119,008)	(111,443)
--	-------	-----------	-----------

Cash at beginning of year

	22,510	184,865	207,375
--	--------	---------	---------

Cash at end of year

	\$ 30,075	65,857	95,932
--	-----------	--------	--------

SEE NOTES TO FINANCIAL STATEMENTS

THE GLEN OF PACIFIC GROVE HOMEOWNERS ASSOCIATION  
NOTES TO FINANCIAL STATEMENTS  
August 31, 2005

(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 restricted and is transferred to the replacement 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, 2005

(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, 2005, regular annual assessments were payable to the Association in monthly installments of \$306 per unit per month.

(CONTINUED)

THE GLEN OF PACIFIC GROVE HOMEOWNERS ASSOCIATION  
NOTES TO FINANCIAL STATEMENTS  
August 31, 2005

(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 Barrera and Company, Inc. in October 2005. The 2005/2006 annual budget, which was approved by the Board of Directors in July 2005, does not provide for sufficient contributions to catch up the under funded amount by August 31, 2006. Consequently, the replacement fund is estimated to be under funded by approximately \$208,167 (\$3,469 per unit) by August 31, 2006. Accordingly, it is expected that higher regular assessments or special assessments may be necessary in the future.

(CONTINUED)

THE GLEN OF PACIFIC GROVE HOMEOWNERS ASSOCIATION  
NOTES TO FINANCIAL STATEMENTS  
August 31, 2005

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

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, 2005, 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, 2005 was \$782. During the year ending August 31, 2005, the Association paid \$510 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, 2005  
 (UNAUDITED)

Barrera and Company, Inc. conducted a study in October 2005 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. A 3% pre-tax interest rate has been applied to the cash flow.

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

<u>Components</u>	Estimated Remaining Useful Lives	Estimated Current Replacement Costs
Roofing	0-29 yrs.	\$ 441,000
Painting	5 yrs	160,000
Asphalt & concrete	0-7 yrs.	63,664
Fencing, gates & bridge	3-17 yrs.	47,470
Water features	0-10 yrs.	40,000
Landscaping	3-14 yrs.	9,900
Lighting	2 yrs.	31,500
Tennis courts	4 yrs.	3,500
Miscellaneous	3-12 yrs.	<u>6,000</u>
Total		<u>\$ 803,034</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, 2005, is \$251,965 with expected contributions of \$82,080 for the year ending August 31, 2006.