

FLYING –O RANCH COMMUNITY ASSOCIATION
NOTES TO COMPILED FINANCIAL STATEMENTS
DECEMBER 31, 2004

1. Nature of organization:

The Flying-O Ranch Community Association is a nonprofit mutual benefit corporation organized for the purpose of operating and maintaining the common areas of the planned unit development known as the Flying-O Ranch located near the city of Coarsegold, California.

2. Summary of significant accounting policies:

Fund Accounting:

The association's governing documents provide certain guidelines for conducting its financial activities. To ensure observance of limitations and restrictions on the use of financial resources, the Association maintains its accounts using fund accounting. Financial resources are classified for accounting purposes in the following funds established according to their nature and purpose:

Operating fund (deficit):

This fund is used to account for financial resources available for the general operations of the association.

Replacement fund:

This fund is used to accumulate financial resources designated for future repairs and replacements.

Member assessments:

Association members are subject to monthly assessments to provide funds for the association's operating expenses, and major repairs and replacements. Assessment receivable at December 31, 2004 represents fees due from the developer and fees due from parcel owners.

No allowance for doubtful accounts has been set up as all the assessments receivable are currently collectible. Substantially all of the outstanding receivable is due from one member.

Property and Equipment:

Real property owned by the Association has been deeded back to members of the developer's family. Easements have been granted to the Association to use the facilities, provided that the Association pays all related maintenance expenses.

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NOTES TO COMPILED FINANCIAL STATEMENTS-CON'T
DECEMBER 31, 2004

Income taxes:

For purposes, the association may be taxed either as a homeowner's association or as a regular corporation. For the year ended December 31, 2004, the association was taxed as a regular corporation. As a regular corporation, non-exempt function income, such as interest, cannot be reduced by the excess of exempt function expenses over exempt function income. However, this excess can be carried forward to offset function taxable income in future years.

For state tax purposes, the taxable income consists of the excess of non-exempt function income over directly related expenses.

3. Future major repairs and replacements:

The Association's governing documents require funds to be accumulated for future major repairs and replacements. Accumulated funds aggregate approximately \$31,064 at December 31, 2004. It is the Association's policy to allocate any interest and lease income to the operating fund.

The Association is funding major repairs and replacements over the estimated useful lives of the various components. The useful lives of the components range from 4 to 30 years. Actual expenditure may vary from the estimated amounts, and the variations may be material. Therefore, amounts accumulated into 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 until funds are available. The fund will not be charged for any costs under two hundred dollars.

4. Related party transactions:

The developer owns a common area parcel as of December 31, 2004.

FLYING –O RANCH COMMUNITY ASSOCIATION
 SUPPLEMENTARY INFORMATION ON FUTURE
 MAJOR REPAIRS AND REPLACEMENTS
 DECEMBER 31, 2004

The owners have not conducted a study to determine the remaining useful lives of the components of the common area property and estimates of the costs of major repairs and replacements that may be required in the future. The estimated useful lives and costs of future repairs and replacements have been based on the original developer's experience.

The following information is based on the original developer's estimates of the useful lives of the common area property and the current costs of major repairs and replacements.

	Estimated Remaining Useful Life (Years)	Estimated Current Replacement Cost	Replacement Fund Balance at <u>December 31, 2004</u>
Component:			
Road maintenance			
Gravel	15-20	\$ 40,000	\$ (6,262)
Culverts	15-20	37,000	17,784
Common area maintenance			
House roof	5-7	5,000	3,292
Appliances	5-7	5,000	3,292
Air conditioning and heating	5-7	5,000	3,292
House structure	25-30	30,000	(1,809)
Painting	1-5	1,000	5,746
Barn structure	25-30	15,000	3,292
Water Well	1-5	<u>1,000</u>	<u>2,347</u>
		\$ <u>139,000</u>	\$ <u>31,064</u>

FLYING =O= RANCH COMMUNITY ASSOCIATION
ADDITIONAL NOTES TO ACCOMPANY THE 2005 BUDGET
MARCH 25, 2005

This year we, the Finance Committee and Board, have decided to send you, the Owners, a more detailed description of the budget, including information on how we arrived where we are today, what the various budget categories cover, and some options for your consideration going forward. It is important that you read it and think about how it impacts you. You need to understand the organization, the rules we operate under and the assumptions and decisions that shaped our budget. Please review this information before the owners meeting on April 2 and, if you have questions, either send them before or bring them to the meeting. We'll do our best to answer them for everyone.

Executive Summary:

This transition year, from Developer operation to Community Association operation, has been an interesting, and scary, learning opportunity. Your Board and Finance volunteers audited past numbers, negotiated new deals to save our money, moved bank accounts, and accountants, and generally took control of the finances of the Flying =O= Ranch. We learned about the laws, what we have to do, where the money goes, and just how much this place costs to operate. One key thing we figured out is that the finances work a bit differently under control of a Developer than an Association. It's quite common in cases like ours for the Developers to keep dues low and subsidize costs in order to make the project sell quickly. It's equally common for Community and Home Owners Associations to discover it costs more to operate than they thought.

During the last 4 years the Flying =O= has run it's operating fund at a deficit, spending more money every year than has been added to the Operating fund from Income. The extra money has come from the Reserve fund and has been accounted for as an inter-fund transfer or loan. By law that money has to be paid back and so we've begun that process with the 2005 budget. We'll do it gradually in order to minimize assessment increases. As our income is not sufficient to cover our operating expenses it is also not sufficient to increase our reserves, which are supposed to gradually increase until needed, like saving for a scheduled rainy day. We *have* been adding to the Reserve fund most years so some of this deficit is an accounting artifact. However, for the last 3 years, we've run at a net cash deficit, spending more than our total Income, resulting in having less money in the bank every year and depleting our Reserves.

We have only two choices obviously, raise more Income or reduce our Expenses. In this years budget and notes you will have a chance to see what we spend money on and decide for yourselves what can be cut, or what is important enough to pay even more to keep. Remember however that this level of Income will NOT sustain this level of Expense. If costs are not cut – dramatically – we are still responsible for coming up with the money to pay, either by raising the Dues or by paying a special Assessment when the bills are due. Funding our Reserves is simply a way to save up so we don't have a huge special assessment when something major needs to be replaced. We should all be aware of what we pay for the value we receive and the use we get from our budgeted items.

FLYING =O= RANCH COMMUNITY ASSOCIATION
ADDITIONAL NOTES TO ACCOMPANY THE 2005 BUDGET
MARCH 25, 2005

1. Nature of organization:

The Flying =O= Ranch community Association is a nonprofit mutual benefit corporation organized for the purpose of operating and maintaining the common areas of the planned unit development known as the Flying =O= Ranch.

Specifically there are two “areas” we operate and maintain. The first area is the Cattle Lease Easement, which consists of all the land except the Home Site (up to 10 acres maximum) on each ranch parcel, and the Roads, which are part of each parcel but are provided to Madera County as an easement on each parcel. These “first” areas are owned by the individual parcel owners. The second area we operate and maintain is the Common Parcel Improvements, which consists of the Equestrian Facility, the Ranch Managers House, the Clubhouse and the Pond. We maintain these so we can keep an easement granted to us under that condition by the owner of that parcel, the Wyle O’Neals Cattle Ranch, Inc. This is kind of like paying rent, but is not like owning real estate. In both cases we have agreed to “band together” to share the cost of maintenance.

Many parts of the legal code apply to our Association so we have to learn and keep track of those requirements. We are subject to the Civil Code, Business and Professions Code, Subdivided Lands Act, Nonprofit Corporation Law, and any number of other local laws. Most of these laws have something to say about how we keep track of your money.

2. Summary of significant accounting policies:

Fund Accounting:

The Association’s governing documents, including the law, the Bylaws and the CC&Rs, provide some guidelines for conducting its financial activities. To ensure observance of limitations and restrictions on the use of financial resources, the Association maintains its accounts using fund accounting. Financial resources are classified for accounting purposes in the following funds established according to their nature and purpose:

Operating fund (deficit):

This fund is used to account for financial resources available for the general operations of the association. Kind of like the family checking account.

Replacement fund:

This fund is used to accumulate financial resources designated for future repairs and replacements. More like the family savings account.

Note the “(deficit)” next to Operating Fund. It is possible, legal, and sometimes the right thing to do to operate at a deficit, usually for a short time. Think of that capability as analogous to your checking overdraft protection. However, in our case we don’t have a line of credit with a bank that allows us to overdraft our operating account but rather it is possible to “borrow” the money from our other fund or

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ADDITIONAL NOTES TO ACCOMPANY THE 2005 BUDGET
MARCH 25, 2005

“bucket” – the Replacement Fund. We are required by law to pay it back or at least account for how it is spent on items for which it was reserved.

Member assessments:

Association members are subject to monthly assessments to provide funds for the association's operating expenses, and major repairs and replacements. We are collectively responsible for certain expenses, shown in the budget, and we depend on everyone paying their assessments on time. Assessments receivable at December 31, 2004 represents fees due from the developer and fees due from parcel owners.

No allowance for doubtful accounts has been set up as we expect that all the assessments receivable are eventually collectible. There are only a very few Association members behind on their dues and we hope you will all pay up soon!

Property and Equipment:

The Association owns some things we are responsible for maintaining, like the powered gates. This is the only significant property of the Association. We're also responsible for maintaining the common roads easement area that passes through most owner's parcels. Finally, the Association is responsible under the terms of the CC&Rs for maintaining the Cattle Ranch Improvements on the parcel owned by Wyle O'Neals Cattle Ranch, Inc., parcel #27. In return, we have been granted an easement to use the facilities on that parcel, as long as we pay all the related maintenance expenses, including a portion of the property taxes for that parcel. Since the portion is based on how much we use the common parcel versus how much the owners use the common parcel the “portion” is currently 100%. If the owners build out a Home Site, as they are allowed by the CC&Rs, this portion may fall.

Income taxes:

The association may be taxed either as a homeowner's association or as a regular corporation. For the year ended December 31, 2004, the association was taxed as a regular corporation. As a regular corporation, non-exempt function income, such as interest, cannot be reduced by the excess of exempt function expenses over exempt function income. However, this excess can be carried forward to offset function taxable income in future years. For state tax purposes, the taxable income consists of the excess of non-exempt function income over directly related expenses.

3. Future major repairs and replacements:

Last terms' finance committee began a study to determine the remaining useful lives of the components of the common area property and estimates of the costs of major repairs and replacements that may required in the future. This study is not complete and so for the 2005 budget we are using updated estimates derived and extrapolated from the 2004 budget numbers. The estimated useful lives and costs of future repairs and replacements used in the 2004 budget were based on the original developer's experience.

**FLYING - O RANCH COMMUNITY ASSOCIATION
STATEMENT OF OPERATING FUND
REVENUE AND EXPENSES
BUDGET
December 31, 2005**

Income		
Monthly Assessments (Dues)		29,700.00
Interest Earned		300.00
Pasture Rentals		4,760.00
Total Revenues		<u>34,760.00</u>
Expenses		
Accounting Fees		1,800.00
Insurance - Association Liability		5,000.00
Insurance on Structures in Common Area		1,600.00
Office Supplies		300.00
Repairs & Maintenance		
Barn		300.00
Clubhouse (Includes Supplies,Cleaning @60 a month)		1,190.00
General Ranch Maintenance		500.00
Ranch House		300.00
Repairs		300.00
Other		100.00
Total Repairs & Maintenance		2,690.00
Road Maintenance		
Road Grading & Gravel		6,000.00
Truck Fuel - Ranch Mgr		600.00
Repairs (Culverts, Erosion, brush....)		1,500.00
Total Road Maintenance		8,100.00
Utilities		
Electricity		800.00
Propane		300.00
Telephone - Clubhouse		500.00
Trash Disposal		1,500.00
Web Site		120.00
Total Utilities		3,220.00
Replacements and Improvements		7,800.00
Federal Income Taxes		700.00
State Income Taxes		450.00
Property Taxes		2,100.00
Miscellaneous Expenses		200.00
Total Expenses		<u>33,960.00</u>
Excess (deficit) of Operating Revenues over Operating Expenses		800.00

FLYING - O RANCH COMMUNITY ASSOCIATION
SUPPLEMENTARY INFORMATION ON FUTURE MAJOR REPAIRS AND REPLACEMENTS
December 31, 2004

The Association has not yet conducted a study to determine the remaining useful lives of the components of the common area property and estimates of the costs of major repairs and replacements that may be required in the future. The estimated useful lives and costs of future major repairs and replacements are based on the estimates of the Finance Committee.

<u>Component:</u>	<u>Estimated Remaining Useful Life (Years)</u>	<u>Estimated Current Replacement Cost</u>	<u>Replacement Fund Balance at December 31,2004</u>
Ranch Mgr House			
Roof (Comp Shingle)	10	\$ 10,000.00	\$ 1,149.68
Deck	19	\$ 5,000.00	\$ 574.84
Appliances and systems	5	\$ 12,000.00	\$ 1,379.61
Main Structure (1680 sf)	30+	\$ 150,000.00	\$ 17,245.14
Tool Shed (512sf)	14	\$ 12,000.00	\$ 1,379.61
Fences	29	\$ 2,000.00	\$ 229.94
Well	15	\$ 5,000.00	\$ 574.84
Equestrian Facility			
Barn (3648sf)	34	\$ 60,000.00	\$ 6,898.06
Metal roof	24	\$ 15,000.00	\$ 1,724.51
Corrals (1380' Rail Fences)	15	\$ 11,040.00	\$ 1,269.24
41 gates	15	\$ 7,175.00	\$ 824.89
Tack Room (864sf)	30+	\$ 35,000.00	\$ 4,023.87
Metal roof	25	\$ 5,000.00	\$ 574.84
Round Pen	10	\$ 2,000.00	\$ 229.94
Clubhouse			
Main Structure (768sf)	30+	\$ 65,000.00	\$ 7,472.89
Metal roof	30+	\$ 5,000.00	\$ 574.84
Trex Deck	14	\$ 5,000.00	\$ 574.84
Entrance Gates			
Front Gate	4	\$ 4,500.00	\$ 517.35
Rear Gate	3	\$ 4,500.00	\$ 517.35
Fences			
Pond	25	\$ 2,500.00	\$ 287.42
Pond (Spillway, Dam, Dock)			
Repair Dam	30+	\$ 11,000.00	\$ 1,264.64
Repair Spillway	30+	\$ 2,000.00	\$ 229.94
Replace Dock	18	\$ 2,000.00	\$ 229.94
Roads			
Replacement of Culverts	10	\$ 37,000.00	\$ 4,253.80
		\$ 469,715.00	\$ 54,002.00